December 28, 2012

**TO:** Board of Directors

**FROM:** Bret D. Edwards
Director
Division of Resolutions and Receiverships

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**SUBJECT:** Notice of Proposed Rulemaking Regarding the Retention of Records of an Insured Depository Institution in Receivership

## RECOMMENDATION

The attached Notice of Proposed Rulemaking ("NPR") proposes a regulation to clarify a provision of the Federal Deposit Insurance Act ("FDI Act") that addresses the retention of the records of an insured depository institution by the FDIC as receiver. The proposed regulation would define the term "records" and enable the FDIC to implement a records retention policy in compliance with 12 U.S.C. §1821(d)(15)(D). It is recommended that the Board of Directors approve the NPR and authorize its publication in the Federal Register with a 60-day comment period.

## EXECUTIVE SUMMARY

Section 11(d)(15)(D) of the FDI Act (12 U.S.C. section 1821(d)(15)(D), hereafter "Section 1821(d)(15)(D)") provides that after the end of the six-year period beginning on the date of its appointment as receiver, the FDIC may destroy any records of a failed insured depository institution that the FDIC in its discretion determines to be unnecessary, unless directed not to do so by a court of competent

jurisdiction or governmental agency or prohibited by law. In addition, the FDIC may destroy any records that are at least 10 years old as of the date of appointment. The proposed rule incorporates these time frames and adds that the FDIC will not destroy records when there is a legal hold imposed by the FDIC.[1]

The term "records" is not defined in the FDI Act and the legislative history does not provide any guidance on how the term should be interpreted. In the proposed rule, the term "records" is defined to focus on documentary material that was generated or maintained by an insured depository institution in the course of and necessary to its transaction of business as an insured depository institution. In making its determination as to what constitutes records, the FDIC would consider four factors: (1) whether the documentary material relates to the business of the failed insured depository institution; (2) whether the documentary material was generated or maintained by the failed insured depository institution in accordance with its own recordkeeping practices and procedures or pursuant to standards established by the failed insured depository institution's regulators; (3) whether the documentary material is needed by the FDIC to carry out its receivership function; and (4) the expected evidentiary needs of the FDIC as receiver of the failed insured depository institution.

The proposed rule also provides that the FDIC's transfer of records to a third party in connection with that party's acquisition of assets or assumption of liabilities will satisfy the records retention obligations under Section 1821(d)(15)(D) so long as

[1] A legal hold is a suspension of the routine disposal of paper and electronic documents, data, and other records in any format that may be potentially relevant to litigation or other matters in which documents must be produced.

the transferee agrees that it will not destroy the transferred records for 6 years from the date of the appointment of the FDIC as receiver.

**DISCUSSION**

**I. Background**

When acting as receiver of a failed insured depository institution, the FDIC succeeds to the books and records of the institution.[2] Section 1821(d)(15)(D) provides that after the end of the six-year period beginning on the date of its appointment as receiver, the FDIC may destroy any records of a failed insured depository institution that the FDIC in its discretion determines to be unnecessary, unless directed not to do so by a court of competent jurisdiction or governmental agency or prohibited by law. In addition, the FDIC may destroy any records that are at least 10 years old as of the date of appointment. The specific provisions read as follows:

> (i) IN GENERAL. Except as provided in clause (ii), after the end of the 6-year period beginning on the date the Corporation is appointed as receiver of an insured depository institution, the Corporation may destroy any records of such institution which the Corporation, in the Corporation's discretion, determines to be unnecessary unless directed not to do so by a court of competent jurisdiction or governmental agency, or prohibited by law.
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> (ii) OLD RECORDS. Notwithstanding clause (i), the Corporation may destroy records of an insured depository institution which are at least 10 years old as of the date on which the Corporation is appointed as the receiver of such depository institution in accordance with clause (i) at any time after such appointment is final, without regard to the 6-year period of limitation contained in clause (i).

The term "records" is not defined in the FDI Act and the legislative history does not provide any guidance on how the term should be interpreted. A broad

[2] 12 U.S.C. §1821(d)(2)(A).

interpretation is problematic because it would encompass not only all documentary materials that clearly relate to the business of the institution but also materials that have no relevance to its business, or which lack evidentiary value and would not ordinarily be considered "records." In addition, advances in information technology and data storage capabilities have substantially increased the volume of material generated by financial institutions. To illustrate, a "terabyte" of electronically stored information ("ESI") is the equivalent of 77 million printed pages. A typical failed insured depository institution has between 3 and 9 terabytes of ESI, or between 231 million and 693 million pages of material. Currently, the FDIC is housing on its recordkeeping systems 775 terabytes of data from failed insured depository institutions for which the FDIC has been appointed as receiver since 2007 – the equivalent of 59.675 billion pages. If the term "records" were to be interpreted to encompass all documentary material that the FDIC as receiver obtains from a failed insured depository institution, regardless of its significance or evidentiary value, then the capture, processing, and maintenance of ever-increasing amounts of such material would pose significant unnecessary burdens and inefficiencies both now and in the future. For this reason, staff recommends proposing a rule to define the term "records" in order to designate more specifically the materials that are subject to the FDI Act's record retention requirement, thereby enabling the FDIC to manage the records of insured depository institutions in receivership more efficiently and in a legally appropriate manner.

## II. The Proposed Rule

### A. Authority and Purpose

The FDI Act gives the FDIC broad authority to carry out its statutory responsibilities. Section 11(d)(1) of the FDI Act authorizes the FDIC to "prescribe such regulations as [it] determines to be appropriate regarding the conduct of conservatorships or receiverships."[3] Additionally, section 10(g) of the FDI Act authorizes the FDIC to prescribe regulations, including defining terms, as necessary to carry out the FDI Act.[4] The purpose of the proposed rule is to identify more specifically the materials that are subject to the FDI Act's records retention provision thereby enabling the FDIC to manage the records of an insured depository institution in receivership in a realistic, efficient and legally appropriate manner.

### B. Section-by-Section Analysis

*Definitions*

Under the proposed rule, documentary materials will be characterized as records for purposes of Section 1821(d)(15)(D) by meeting a formal definition (paragraph (a)) and a functional test (paragraph (b)). The FDIC believes that this two-tiered approach will have the effect of excluding extraneous material that is not related in any way to the transaction of the failed insured depository institution's business.

Paragraph (a)(3) of the proposed rule defines the term "records" for purposes of Section 1821(d)(15)(D) to mean "any reasonably accessible document, book, paper, map, photograph, microfiche, microfilm, computer or electronically-created

[3] 12 U.S.C. §1821(d)(1).
[4] 12 U.S.C. §1820(g).

record generated or maintained by an insured depository institution in the course of and necessary to its transaction of business." This definition is consistent with the definition of "records" in section 210(a)(16)(D) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[5] which addresses the retention of records of a systemically important financial (non-bank) institution for which the FDIC is appointed as receiver. The qualification in the definition that "records" be "reasonably accessible" reflects the text of Federal Rule of Civil Procedure 26(b)(2)(B), which provides that a party from whom discovery is sought need not provide ESI from sources that the party identifies as not reasonably accessible because of undue cost or burden. (For example, a party may be excused from restoring ESI from aging back-up tapes.) Use of the phrase "reasonably accessible" would make the definition of "records" in the proposed rule consistent with the discovery standard and would also protect the FDIC as receiver from incurring expenses associated with restoring or maintaining the legacy systems of multiple failed insured depository institutions in order to extract documentary material from those systems that is not needed by the Receiver to carry out its functions and was not in use by the insured depository institution to carry out its day-to-day operations prior to its failure.

Paragraph (a) also provides a non-exclusive list of examples of material that will ordinarily be understood to constitute records of the failed institution, specifically, board or committee meeting minutes, contracts to which the insured

[5] 12 U.S.C. 5390(a)(16)(D), which defines "records" to mean "any document, book, paper, map, photograph, microfiche, microfilm, computer or electronically-created record generated or maintained by the covered financial company in the course of and necessary to its transaction of business."

depository institution is a party, deposit account information, employee and employee benefits information, general ledger and financial reports or data, litigation files, and loan documents.

Two types of materials are excluded from the definition of records in paragraph (a)(3). The first exclusion is for multiple copies of records, either in paper or electronic format. The retention of multiple copies is unnecessary and is not cost-efficient. The second exclusion is for examination, operating, or condition reports prepared by, on behalf of, or for the use of the FDIC or any agency responsible for the regulation or supervision of insured depository institutions. The FDIC has consistently maintained that reports of examination and other confidential supervisory correspondence or information prepared by FDIC examiners with respect to an open insured depository institution belong exclusively to the FDIC and not to the insured depository institution, but insured depository institutions often retain copies of reports of examination and other supervisory correspondence.

*Determination of Whether Material Constitutes Records*

In determining whether particular material obtained from a failed insured depository institution constitutes a record, the FDIC will consider four factors set forth in paragraph (b). If the FDIC in its discretion determines that one or more of the factors weigh in favor of classifying the material as a record, it will be classified as a record for purposes of Section 1821(d)(15)(D).

The first factor is ***whether the documentary material relates to the business of the failed insured depository institution***. This factor is modeled after section 210(a)(16)(D)(iii) of the Dodd-Frank Act defining "records" as materials generated or

maintained "in the course of and necessary to [the institution's] transaction of business."

The second factor is ***whether the documentary material was generated or maintained in accordance with the failed insured depository institution's own recordkeeping practices and procedures or pursuant to standards established by the failed insured depository institution's regulators***. Thus, the FDIC will consider whether documentary material was retained pursuant to the insured depository institution's recordkeeping practices when determining whether specific documentary material is a record for the purposes of Section 1821(d)(15)(D) and the proposed rule. Likewise, the FDIC will consider whether documentary material was retained pursuant standards imposed by state or federal regulators when determining whether specific documentary material is a record for the purposes of Section 1821(d)(15)(D) and the proposed rule.

The third factor ***is whether the documentary material is needed by the FDIC to carry out its functions as receiver***. This inquiry would permit the classification of documents as records when they are used by the FDIC to carry out its function as receiver, for example, to transfer the failed insured depository institution's assets or liabilities, assume or repudiate the institution's contracts, determine claims, and collect liabilities owed to the institution.

The fourth factor used to determine whether documentary material should be classified as records is ***the expected evidentiary needs of the FDIC***. Records generated and maintained by the failed insured depository institution are used to support enforcement actions and litigation. In addition, records of the insured

depository institution may also be required to respond to requests filed under the Freedom of Information Act. This factor is modeled on section 210(a)(16)(D)(i)(II) of the Dodd-Frank Act requiring the FDIC to prescribe record retention regulations with due regard for "the expected evidentiary needs of the Corporation as receiver of a covered financial company and the public regarding the records of covered financial companies."[6]

Paragraph (c) of the proposed rule explains that the FDIC's designation of materials as records pursuant to paragraph (b) is solely for the purpose of identifying records that are subject to the retention requirements of Section 1821(d)(15)(D). The designation has no bearing on the discoverability or admissibility of documentary materials in any court, tribunal or other adjudicative proceeding, nor on whether such documentary materials are subject to the Freedom of Information Act, the Privacy Act or other law.

*Destruction of Records*

Section 1821(d)(15)(D) sets forth the timeframes for the destruction of a failed insured depository institution's records. Paragraph (d) of the proposed rule incorporates these timeframes: after the end of the six-year period beginning on the date of its appointment as receiver, the FDIC may destroy any records of a failed insured depository institution that the FDIC in its discretion determines to be unnecessary to maintain, unless directed not to by a court of competent jurisdiction or governmental agency or prohibited by law. The FDIC may also destroy any records that are at least 10 years old as of the date of appointment. In addition, the proposed rule provides that the FDIC will not destroy records subject to a legal hold imposed

[6] 12 U.S.C. § 5390(a)(16)(D)(i)(II).

by the FDIC. By including legal holds, the proposed rule implements the policy of the FDIC to preserve information (both ESI and paper) that the FDIC may be required to produce to opposing parties in litigation or when otherwise subject to a legal requirement to produce information.

*Transfer of Records*

In many resolutions of failed insured depository institutions, an acquiring institution will purchase assets or assume liabilities of the failed insured depository institution and, in such a case, must obtain custody of records related to such assets and liabilities. Paragraph (f) of the proposed rule provides that the FDIC's transfer of records to a third party in connection with that party's purchase of assets or assumption of liabilities will satisfy the records retention obligations under Section 1821(d)(15)(D) so long as the transfer is made pursuant to a purchase and assumption agreement under which the transferee agrees that it will not destroy the transferred records for at least 6 years from the date of the appointment of the FDIC as receiver of the failed insured depository institution unless otherwise notified in writing by the FDIC.

*Policies and Procedures*

Paragraph (f) of the proposed rule provides that the FDIC may establish policies and procedures with respect to the retention and destruction of records. It is expected that these policies and procedures will address specific matters related to the capture, processing and storage of failed bank records, such as collecting computer hard drives, email databases, and backup and disaster recovery tapes.

## CONCLUSION

It is recommended that the Board of Directors approve and adopt the NPR and authorize its publication in the Federal Register with a 60-day comment period.

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