Financial Reform

The Role of General Counsel in Global Information Governance

In March 2009, there were countless articles discussing whether the stock market had hit bottom after the financial crisis of 2008 dramatically impacted the global banking system.[1] There was an unprecedented sense of both personal and organizational risk that was influencing decision-making throughout the economy. In a speech President Obama delivered in June 2009 introducing pending financial reform, he stated "Financial institutions have an obligation to themselves and to the public to manage risks carefully." Less than a year later, in July 2010, President Obama signed one of the most sweeping bills, the Dodd-Frank Wall Street Reform and Consumer Protection Act, into law.[2]

Over the past few years, the role of general counsel has included evaluating those risks, specifically as they relate to their organization's reputation, operations, and business practices to ensure that compliance practices are consistent with evolving standards.[3] They have often tempered that risk by marrying technology to each new challenge in an effort to streamline their organization's approach, understanding that a proactive plan is much more powerful than a reactive series of disconnected decisions. Going forward a unified strategy focused on centralization of technology and information will be the hallmark of successful legal departments in this new era of unprecedented regulatory scrutiny.

[1] See Evan Newmark, *Mean Street: Our Hero Calls a Stock Market Bottom*, The Wall Street Journal, March 11, 2009; Vikas Bajaj, *Has the Economy Hit Bottom Yet?*, The New York times, March 14, 2009.

[2] See Barack Obama speech on regulatory reform **http://www.whitehouse.gov/the_press_office/Remarks-of-the-President-on-Regulatory-Reform/**

[3] Gardner Davis, *Regulatory: The Evolving Role of the General Counsel*, Inside Counsel, February 23, 2011.

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"Financial institutions have an obligation to themselves and to the public to manage risks carefully."

— President Obama

Dodd-Frank and the Evolution of Information Management

Legal executives demonstrating dynamic and diverse leadership while armed with a single platform to evaluate and securely control a vast sea of data will help navigate their organizations through a changing regulatory landscape in the financial services industry, and in the broader corporate community. Since Dodd-Frank has the potential to affect other sectors in the future due to its universal focus on enterprise risk management, corporate governance, compliance and even compensation issues, it represents the catalyst driving the evolution in how technology is applied to administer information.[4]

This new paradigm requires enhanced record keeping, greater transparency behind business transactions, and increased regulatory oversight. It is a revised system that is meant to address the turmoil caused by the financial crisis, however the current legislation is still undergoing further revision to provide clarity around many of its provisions.

What is clear is that general counsel to entities that are primarily engaged in investing in securities will be burdened with the risk management associated with ensuring key records and audit trails are maintained and reports are filed with the Securities & Exchange Commission. The goal is to identify and address potential systemic risks in the system before they result in a significant market disruption.

The New Realities of Oversight

Institutions will need to adhere to oversight from a variety of new agencies within the Department of the Treasury as well, including, among others, the Office of Financial Research[5] and the Financial Stability Oversight Council.[6] Both are charged with supporting the mission to:

- Evaluate the financial stability of the U.S. economy and identify key risks
- Promote discipline in the markets
- Address any potentially destabilizing elements in the U.S. financial system

Called the 'CIA of Financial Regulators' by some, the new Office of Financial Research will have the power to subpoena "all data necessary" at any time from banks, hedge funds, private equity firms, and brokerages, among others to prevent another financial catastrophe and monitor risk levels.[7] It can also require companies to submit "periodic reports" to provide status updates.[8]

Despite the fact that many protocols related to these new record-keeping requirements (e.g., length of time to maintain archived records, document inspections by the SEC, and the format of the reports for submission among others), relevant organizations can be burdened with compiling overwhelming amounts of documentation that includes details on:

- The amount and description of assets under management, including details related to off-balance-sheet items
- Counterparty credit risk exposure
- Trading and investment positions
- Policies and practices related to fund valuations
- Additional arrangements that reveal favoritism among investors
- Specific trading practices
- Correspondence surrounding investment practices and trades
- Any other data necessary to evaluate risk

[4] Michael W. Peregrine and Timothy J. Cotter, *Dodd-Frank: The Spillover Impact On Nonprofit Healthcare*, Health Lawyers Weekly, July 30, 2010.

[5] Dodd-Frank, §152(a).

[6] Dodd–Frank, §111(a).

[7] Robert Schmidt, *The Treasury's New Research Office*, Bloomberg Businessweek, September 2, 2010.

[8] Dodd-Frank, §153(a).

Given that the ultimate goal of this new legislation is to gauge the financial health of a company and evaluate any relevant financial, operating, or other risk factors, it is essential that chief legal officers closely coordinate with their counterparts in compliance to establish key data management and retention protocols and develop a document exchange to ensure documents are stored in a centralized location.

More Information in Less Time

This new era of mandated transparency will require legal departments to ensure internal investigations are faster and more accurate than in the past, or else face the risk of heavy fines, lengthy audits, and brand damage caused by media coverage. In fact, in-house legal teams are already facing an increase in internal investigations. More than 40% of U.S. and U.K. companies surveyed in 2010 commenced at least one internal investigation, up from a third of U.S. companies and a fifth of U.K. companies in 2009.[9] As high as 60% of the largest companies surveyed reported commencing at least one internal investigation in 2010 — up from 40% in 2009.[10] And, one-fifth of all respondents listed regulatory matters and investigations among the top areas targeted for spending (and those assessments were made without factoring in the impact of Dodd-Frank because of the timing of the questionnaire).[11]

The survey also revealed that one-fifth of all respondents have handled whistleblower allegations in the past three years and a fifth of the respondents expect them to increase in 2011 due to Dodd-Frank's favorable whistleblower provisions, yielding even more internal investigations.[12] An overwhelming 86% of survey respondents reported that an internal investigation resulted from a whistleblower claim in the previous three years compared to 67% the year before.[13]

Dodd-Frank provides for substantial monetary awards to credible whistleblowers, protection from retaliation by suspected violators, and higher volumes of information to refute damaging allegations, which creates additional challenges for in-house legal teams and the general counsel who leads them.[14]

In addition to whistleblowers, the law also gives regulators more flexibility to liquidate failed financial entities based, again, on requiring substantially more documentation than was necessary in the past.

Lack of Knowledge Regarding Information Governance is No Excuse

Ultimately, while Dodd-Frank is meant to overhaul the U.S. financial markets, it is broad in scope with the power to reach far beyond its target industry. The new law will require relevant organizations to know the character of the information that they produce, process, and store, as well as the location of each piece of data.

In this new era of transparency, any lack of access or knowledge is not a valid excuse for failure to comply with an agency request. These requirements drive home the need for general counsel to have central control of information in a single, secure and searchable platform to ensure that documentation is effectively managed and available for reporting.

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[9] Fulbright & Jaworski, 7th *Annual Litigation Trends Survey Report*, 2010 at 32.

[10] *Id.*

[11] *Id.* at 28.

[12] *Id.* at 35.

[13] *Id.* at 36.

[14] Dodd-Frank, §922(a).

Despite its thousands of pages, sixteen titles, hundreds of new rules, detailed studies and periodic reports, Dodd-Frank is ultimately meant to serve as a call to action regarding information management.

Many organizations maintain their information in a disparate series of locations across offices and, potentially, the world according to the preferences of the individuals creating the data. In addition to choosing where the data is saved, they often choose the format and the level of security for the document. Concerns over data security become critical once documents and data reach external law firm contacts or other outsourcing vendors. The filing cabinet phenomenon that employees use to manage their inbox data has created a dangerous perfect storm of inefficient information data capture and security risks that have intensified the need for information governance under the sweeping regulatory power of Dodd-Frank. While these concerns present significant challenges for many organizations, they are no longer valid as a defense of non-compliance to government scrutiny.

General counsel must leverage technology to access key documents and communications, as well as to create an audit trail of that access for the entire archive of internal and external information that impacts the organization.

Reshaping Information Governance for In-House Counsel

The primary mission of Dodd-Frank is to protect the U.S. economy along with American consumers, investors and businesses.[15] It is also designed to eliminate public bailouts of private institutions by providing a system for gauging the stability of the financial industry and eliminating loopholes that led to the economic recession.

Despite its thousands of pages, sixteen titles, hundreds of new rules, detailed studies and periodic reports, Dodd-Frank is ultimately meant to serve as a call to action regarding information management. It will create, merge, and eliminate various government agencies to streamline regulation and amend key provisions of the Federal Reserve Act and the Securities & Exchange Act, among others.

Improving Recordkeeping to Enhance Responsiveness

In order to properly prepare for this, general counsel can not merely follow the principles that have made them successful in the past. Those who develop a new strategy that includes systems and best practices for retaining necessary data will have a clear audit trail and fewer documents to wade through when the government files a request or upon initiating an internal review.

Ironically, by deleting information that an organization stores centrally according to a pre-approved retention and destruction policy, in-house counsel can reduce the risks associated with that data and reduce costs accordingly. This is critical since 98% of respondents to a 2010 study of Global 1000 companies agreed that rigorous discovery and defensible disposal of information is critical, yet 78% admitted that they were unable to immediately dispose of that material.[16]

Part of the problem is unifying information, but with the implementation of Dodd-Frank's vast web of requirements, those organizations that are unprepared will need to readjust their efforts quickly. In fact, 75% of those Global 1000 representatives surveyed agreed that an effective information governance program includes routine linkage and transparency across legal, records and IT, yet less than a third reported following those practices.[17] Consequently, it may not be surprising that 85% cited the need for a new approach with new processes and consistent collaboration across legal, records, and IT as a critical success factor.[18]

[15] Dodd-Frank, §112(a)(1).

[16] Compliance, Governance and Oversight Council, *Benchmark Report on Information Governance in Global 1000 Companies* (CGOC Publication, 2010).

[17] *Id.*

[18] *Id.*

Interpreting Dodd-Frank

General counsel must interpret Dodd-Frank narrowly as it relates to their particular organization (since the law only governs certain institutions), but also broadly as it affects the overall business operations given the creation of the Bureau of Consumer Protection. Almost every element of the legislation has an impact on data and reporting. In addition, negative reactions to inconsistent or low quality data treatment could prompt unwarranted government scrutiny. As a result, in-house legal teams must set practical strategy based on a clearly defined timeline and with the input of senior management.[19]

Of course, legal counsel for smaller investment advisers (including hedge funds and private equity firms) must be especially vigilant since those entities are now required to register with the SEC. In addition, the Federal Reserve will supervise certain non-bank financial institutions and their subsidiaries in the same manner and to the same extent as if they were a bank holding company.

Given that the regulatory framework for implementing the new law is still in development, the senior legal team has time to collaborate with other executives to phase in remediation of its data quality, invest in new tools that reduce risk, centralize information governance, and generate accurate reports that could comply with an immediate request for information.

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The European Response to Dodd-Frank and its Impact in the U.S.

This effort is certain to extend overseas as well given the European Union's equally broad initiatives to contain financial malfeasance.

The Markets in Financial Instruments Directive ("MiFID")

In an effort to harmonize enforcement across multiple borders, MiFID replaced the Investment Services Directive effective November 1, 2007 to streamline regulation of those companies that perform "investment services and activities" in the E.U.'s 27 member states, as well as Iceland, Norway, and Liechtenstein.[20] As part of Europe's Financial Services Action Plan, MiFID is designed, like Dodd-Frank, to increase consumer protection by limiting the products and services that financial institutions can offer to specific customers based on their risk profile and characteristics, distinguishing them by their knowledge of the banking system.

Similar to Dodd-Frank, MiFID also addresses issues related to market structures, transparency in trading, market data consolidation, commodity derivatives, and transaction reporting. Although it too is focused on the financial sector, its investor protection provisions could impact securities issuers and underwriters, as well as utilities, energy, and commodities firms.

In addition, while regulation is specific to the country in which a company is registered and excludes branches of non-E.U. companies (e.g., the MiFID does not apply to a London-based branch of a U.S. firm, unless it is a separate entity incorporated or formed in one of the countries governed by the MiFID), its passport provision allows that entity to provide services to customers in other E.U. member states. This flexibility makes it easier and cheaper to conduct cross-border transactions.

[19] John Adams, *Ready or Not: The IT Challenges of Dodd-Frank*, Information Management Online, September 1, 2010.

[20] Directive 2004/39/EC of the European Parliament and of the Council, April 21, 2004.

As such, strong information governance principles translate domestically as well as internationally, particularly since global investigations involve the added intricacies of foreign laws governing data privacy, language variations, format distinctions, and varied media in a host of disaggregated locations.

Among other changes, MiFID expands the definition of "tradable financial products" to include commodity transactions, as well as freight, climate and carbon derivatives. That expansion in scope will present the need to monitor various transactions more closely. The European Securities and Markets Authority is currently reevaluating the provisions of MiFID. It held a public notice period in 2010 and the European Commission issued a report of its findings. The Commission expects to release its final recommendations by the end of 2011.

The convergence of these rules represents a universal truth that most modern organizations are subject to not just one law in one jurisdiction, but rather to a dynamic sea of change in governance.

Bribery Act 2010

In a 2011 survey by Ernst & Young of 2,365 professionals in 25 European countries, two thirds admitted that bribery and corruption was widespread in their country.[21] In addition, nearly half were unaware of any corporate anti-bribery policy.[22] For those reasons, the U.K.'s Bribery Act 2010, designed to eliminate bribery in corporate transactions, is saddled with great expectations and may apply to U.S. entities conducting business in the U.K., even through a local subsidiary, joint venture, employee, agent, or contractor.

For general counsel concerned with a more global information strategy, the U.K. law does provide an affirmative defense for organizations that maintain appropriate policies and procedures to prevent bribery.[23] Those that feature provisions for risk assessment, due diligence, communication, and training can be particularly effective.

As such, strong information governance principles translate domestically as well as internationally, particularly since global investigations involve the added intricacies of foreign laws governing data privacy, language variations, format distinctions, and varied media in a host of disaggregated locations. That complexity makes it more difficult for legal departments with decentralized and unsecured data practices to demonstrate the absence of corruption when the trend toward global enforcement of such fraud is at a peak.

Next Steps for In-House Counsel

Instead of solely addressing the provisions of one law in the U.S. or multiple restrictions overseas, in-house counsel must develop a unified approach internally that will be the most adaptable to the external challenges that lie ahead. This is particularly important given that the final regulations relating to Dodd-Frank and other reform is far from established.

In early 2011, for example, Republican legislators began introducing bills designed to change and repeal portions of Dodd-Frank.[24] In addition, there are other developments occurring at the House Financial Services Committee, the Federal Deposit Insurance Corporation, and the U.S. Department of the Treasury, among others to impact economic oversight.

From mortgage loan origination fees to debit card "swipe" fees, there is extensive discussion about the micro-issues related to the new financial reform laws. General counsel, however, must be mindful of the macro aspects of its passage as well since it is not necessarily the industry that matters. Rather, it is an organizational record keeping challenge. Those teams that can securely catalogue and immediately reference any piece of centralized information will be capable of addressing all reforms, whether they are related to finance, healthcare, energy or any other industry that routinely faces changes in federal oversight.

[21] Kirstin Ridley, *Bribery Rife Across Europe's Top Companies-Survey*, Reuters, May 18, 2011.

[22] *Id.*

[23] Bribery Act 2010, §7.

[24] See S. 712, The Financial Takeover Repeal Act of 2011, April 1, 2011 (cosponsored by 18 Republican senators).

Refocus and Reinvent

Accordingly, while Dodd-Frank is transforming its target agencies and refocusing consumer protection in the financial sector, corporations large and small must begin to reinvent their information governance protocols. Those that transform from reactive information archivists to proactive data managers will seamlessly address any pending changes. Their firm-wide understanding of the location, character and breadth of their material will provide a compliance and litigation readiness that federal monitors have come to expect.

To meet those expectations, in-house legal teams should begin the preparation process by conducting a thorough audit and remediation of their organization's data. This effort will streamline both relevant and irrelevant files for future reference. It will also prompt information governance experts to create or embrace uniform internal standards across the globe for the description (and subsequent identification) of data, as well as a standardized methodology for classifying transactions that may relate to a pending Dodd-Frank inquiry.

An initiative of this type will establish or renew an internal commitment to data governance and data quality, but in doing so, it is critical that senior legal officers enlist the support of their management counterparts throughout the organization. The need for secure centralized data programs is a cross-disciplinary imperative that Dodd-Frank and its overseas counterparts only heighten. Support at the leadership level will refocus the entire company on a broadly accepted set of internal governance protocols to align and manage the efforts.

Develop Governance Solutions By Understanding Information Problems

Ultimately, to develop solutions, legal teams must first understand the information that is presenting potential problems. Irrespective of the legislation, request for information or internal investigation, those organizations that implement a single, searchable and centralized electronic repository of company information are armed for anything, rather than one big thing. They have the capability to access the full scope of data quickly and in compliance with Dodd-Frank, Europe's new laws and regulations, as well as the next set of restrictions in the ever-changing global regulatory climate.

Since one of the goals of both Dodd-Frank and MiFID is to give companies greater insight into the operations of others with which they are transacting business, legal teams should also consider engaging in collaborative conversations with industry organizations or sector associations. That knowledge sharing effort will validate and benchmark these best practices. It will also provide a forum in which to generate others.

Conclusion

In order to effectively manage risk and remain audit ready in the era of Dodd-Frank and similar demands, general counsel needs to create a data governance policy and a central repository for important information that promotes transparency, enables the firm to be audit ready, and promotes risk readiness. General counsel needs to work with internal stakeholders to establish a platform that is designed specifically to enable them to manage risk in a central location, integrate seamlessly with existing systems, is permission-based, streamlines contract management and version control, promotes regulatory compliance with full audit trails, and is accessible via web or mobile device.

Those teams that can securely catalogue and immediately reference any piece of centralized information will be capable of addressing all reforms, whether they are related to finance, healthcare, energy or any other industry that routinely faces changes in federal oversight.

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