CORPORATE counsel

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You Can Bank on It

More government scrutiny for financial institutions is inevitable.

By Amy Miller

(December 1, 2008) In-house lawyers at financial institutions never had it easy, but the current economic crisis is making their jobs even tougher. They're having to coordinate their companies' responses to government investigators who want to know how things went so wrong. And even as banking lawyers try to clean up past messes, they're anticipating new laws and regulations for their industry.

Financial institutions have long drawn scrutiny from a wide range of agencies, including the Securities and Exchange Commission and the Commodity Futures Trading Commission. Commercial banks additionally have to answer to the Federal Reserve System and the Office of the Comptroller of the Currency.

As a result, these companies typically have well-staffed compliance departments that try to catch problems before they become public scandals, says Michael Roster, the former general counsel of Golden West Financial Corporation. At most financial institutions, one set of lawyers handles securities regulations and another team handles banking regulations, according to Roster, who left Golden West shortly after it was acquired by Wachovia Corporation last year.

Roster doesn't think the financial meltdown can be blamed on inadequate compliance departments. It's due more to a lack of sound judgment, he says. But he concedes, "In retrospect, some would say everyone was looking the wrong way."

According to compliance expert Richard Cellini, in-house lawyers are carefully examining financial statements to see what investors were told about potential risks, and how accurate that information was. Cellini is a senior vice president of business and legal affairs at Integrity Interactive Corporation, a Waltham, Massachusetts-based firm that helps companies set up compliance systems and deal with compliance failures.

Cellini predicts that in the future, the SEC will require companies to define and explain material risks in their company filings much more clearly. "Too often, companies report in great detail about narrow or technical or nonfatal risks, and when it comes to the company-threatening risks, they don't provide enough information," he says.

Government investigators are closely scrutinizing financial documents, too. The Federal Bureau of Investigation, the U.S. Department of Justice, and several state attorneys general are examining possible mortgage and securities fraud at dozens of companies. As always, in-house lawyers will take the lead in responding to these probes, gathering documents and materials, and working with outside counsel.

Besides the investigations, corporate counsel also have to decipher the $700 billion bailout package that Congress passed in October. Complicated rules govern how the big banks can spend their share of the money. "There are all kinds of strings attached," says Roster. "And the lawyers are trying to figure out what that means."

Everyone agrees that Congress will enact more restrictions when it reconvenes in January. Daniel Crowley, a K&L Gates partner who is the former head of government relations for The Nasdaq Stock Market, Inc., says that the financial industry "is going to see the biggest rewrite [of regulations] since the New Deal."

But which agencies will enforce these new regulations is anyone's guess. "Will the SEC be confined to disclosure and to making a few inspections?" asks James Doty, a former SEC general counsel who is now a partner at Baker Botts. "Will the federal banking agencies all be collapsed into one branch? Those are the real questions that confront Congress."

That's why financial institutions have to get involved in shaping the inevitable legislation by stepping up their lobbying operations on Capitol Hill, according to Crowley. He says, "The fundamental decision in-house counsel have to make is: Are they going to be in a passive response mode? Or are they going to proactively influence these rules?"

The increased workload for law departments is coming at a bad time, says Saul Pilchen, a partner at Skadden, Arps, Slate, Meagher & Flom. He explains that companies are tightening their legal budgets as their profit margins shrink. "Compliance departments are being asked to do more with the same resources or even fewer resources," Pilchen says. "That can be a recipe for an unhappy outcome. When you stretch people thinner, they make mistakes."

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