

New financial regulations will increase compliance burdens

Corporate legal departments may look to legal process outsourcing to lower costs.

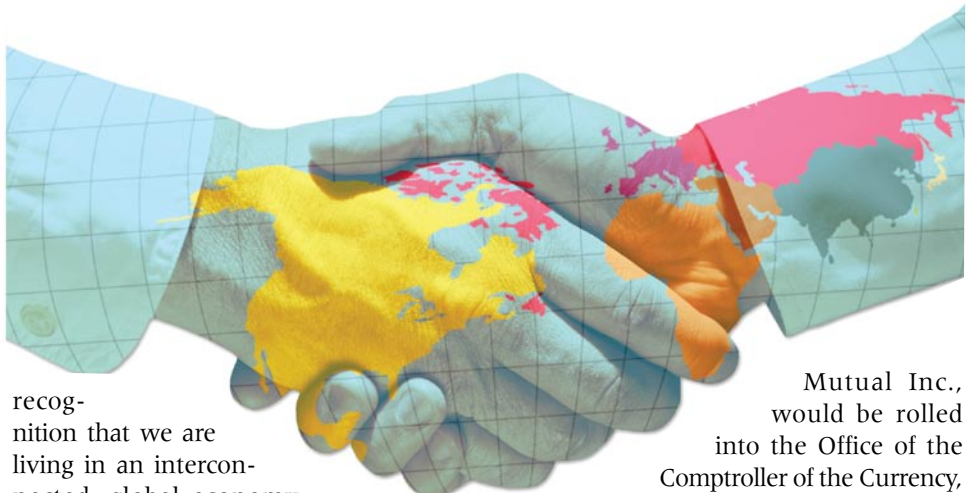
BY GEORGE B. HEFFERAN III

It is no surprise that, in the context of a major recession blamed by some in part to a lack of regulation, the new administration would implement wide-ranging rules to try to avoid or limit the causes of future downturns. Unfortunately, responding to financial crises by greatly increasing regulation has become part of the politician's playbook. Indeed, the June 17 release of the much-awaited proposal, "Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation" (FRR), issued by the Department of the Treasury, quickly exposed a philosophic debate as to the best way to protect against future recessions caused in large part by financial market meltdowns.

IN-HOUSE COUNSEL

The 89-page plan proposes a regulatory structure that will protect large institutions (those deemed too big to fail) but subject them to more stringent and failsafe reporting. Some commentators argue that any proposed regulations need to prevent institutions from becoming too big in the first place. See, e.g., Eric Dash, "If it's Too Big to Fail, Is it Too Big to Exist?," N.Y. Times, June 21, 2009, at WK3. There is, however, one inescapable result from the debate. Whatever plan is implemented will increase significantly the compliance burdens of American corporations at a time when they can least afford an expansion of their legal spend.

There is also a telling note in the FRR: a



recognition that we are living in an interconnected, global economy. This axiom, justifying increased, cross-border regulation of financial markets, also leads to a creative solution for satisfying the burden of heavier compliance requirements for all American companies. This article highlights the compliance workload implications of the proposed FRR and other new federal regulations and suggests that one offshoot of our interconnected global economy, legal process outsourcing (LPO), may in part be a strategic solution to the increased regulatory climate.

The FRR is a five-part proposal that would reorganize the federal oversight of financial institutions while keeping in place current regulations. The first two goals of the plan are to increase the regulation and supervision of financial firms and markets, respectively. Hedge fund and private equity advisers, for instance, would register with the U.S. Securities and Exchange Commission (SEC) and open their books to regulators. All depository institutions would be subject to the Federal Reserve's bank holding company regulations. The Office of Thrift Supervision, the much-maligned agency that had been the regulator of choice by American International Group Inc., IndyMac Bancorp Inc. and Washington

Mutual Inc., would be rolled into the Office of the Comptroller of the Currency, the Treasury unit supervising the largest banks.

The Federal Reserve would also be given more authority to supervise all firms that pose a threat to financial stability, even those that do not own banks. The plan calls for new, comprehensive over-the-counter derivative regulation as well as enhancing the regulation of the securities markets. It would also require that companies that issue mortgages retain at least 5% of them on their own books to discourage ill-considered lending and marketing of improper loans.

Consumer protection from financial abuse, the third goal of the FRR, will entail the creation of the "Consumer Financial Protection Agency," with far-reaching regulatory authority as well as increased SEC authority to require more disclosures for entities creating consumer debt.

The FRR's fourth goal is the most nebulous of the plan's proposal, but also the most potentially far-reaching, in providing the government with "the tools it needs to manage financial crises," including ways to "resolve nonbank financial institutions whose failure could have serious systemic effects." It is this part of the plan that openly embraces the debated "too-big-to-fail" philosophy.

The fifth and last goal, to “raise international regulatory standards and improve international cooperation,” calls for international financial regulatory reform. Financial institutions must also consider new regulations already implemented by the SEC this year, along with those proposed by the FRR.

In addition to the restructuring of financial regulations, American corporations will feel the strain of new compliance burdens in health care and energy reforms already implemented this year, in addition to those rather ambitious plans currently being debated by the experts in the halls of Congress.

How will corporate legal departments handle the increased obligations resulting from the foregoing at a time when their budgets are being reduced? They can achieve the most effective implementation of these wide-ranging new regulations through a forward-looking strategy that leverages their resources on a cost and efficiency basis. Corporate counsel and outside counsel might want to consider working together to identify labor-intensive compliance legal work, such as basic research and document review, that can be outsourced. That way, the intellectual capital of outside counsel, within budget confines, as well as experienced in-house counsel, can be maximized. Labor-intensive compliance processes that can be offshored will free up the onshore compliance and legal team to work on higher-value legal analysis and strategy. Repeatable processes of the kind often implemented by compliance departments are often the best choices for sending work to LPO companies.

Work sent to legal service providers with attorneys located offshore, to reduce cost, will still need to be supervised by inside and/or outside counsel, though at a significantly lower cost than supervising first- or second-year associates from U.S. law firms or hiring and training new inside counsel staff to handle implementation of the new laws.

ABA APPROVAL

The American Bar Association last year approved the use of legal outsourcing by first noting, as did the FRR, the

globalized economy. ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 08-451 (2008) (“the outsourcing trend is a salutary one for our globalized economy”). In sanctioning the use of LPO companies, the ABA recognized how smaller firms can use offshoring to more effectively represent clients—a justification even more important for small or medium-sized corporations, which face a disproportionately heavier compliance burden than larger entities. The LPO industry has proven its effectiveness in the areas of litigation support and document review in business transactions, legal research and intellectual property support, among others, and American companies should consider LPO utilization to lower the cost of increased compliance workloads to maintain a competitive edge globally. The LPO market has matured, with experienced, large players and more information available about successful client engagements.

As with the selection and utilization of outside counsel, companies should carefully vet LPO companies. Establishing long-term relationships rather than seeking them solely for one-time projects is generally more effective. A corporate client's investment in training and setting up the LPO process will receive a higher return on investment if used in a consistent, routine way. Compliance tracking teams can be set up offshore to monitor and inform business units and corporate counsel in a reliable and time-saving manner. Also, the time differential with the United States, particularly for offshore LPO companies in India and Asia, can be used to the advantage of inside counsel. In-house work that is not completed during the workday can be sent overseas overnight so that the LPO company can complete or significantly move it forward before inside counsel return to work in the morning.

Effectively leveraging offshore legal teams may also mean shifting certain existing corporate legal and outside counsel work to free up the in-house and compliance teams to focus on the new compliance implementation. LPO companies can often be used to handle contract review, multistate and global

research projects, and other redundant and time-consuming corporate legal work.

The cost savings of using an LPO company are meaningless if the quality of the work does not meet or exceed American legal standards. Open and transparent processes should be established to manage and supervise the work flow, with clearly defined roles and authority. With the certainty of increased corporate compliance work during a time of compressed corporate earnings, the use of LPO companies to improve efficiencies and lower legal spend could not be more timely.

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