

Tip of the Month



Managing the Risks and Costs of E-Discovery in Regulatory Investigations

Scenario

A financial institution is being investigated by the Securities and Exchange Commission (SEC) in connection with the institution's role as trustee in certain residential mortgage-backed securitization (RMBS) transactions. The financial institution receives several subpoenas from the SEC seeking detailed information about every RMBS transaction in which the financial institution was involved. The financial institution is concerned about the burden of responding to the SEC subpoenas, but is also concerned about appearing uncooperative and inviting even more scrutiny from the SEC.

E-Discovery Complications in Regulatory Investigations

Organizations face serious consequences for the failure (or the apparent failure) to cooperate with regulatory investigations. The general challenges related to the preservation, collection and production of electronically stored information (ESI) are compounded by several factors, including: (i) the risks related to regulatory investigations, (ii) the frequency of such requests, (iii) the possibility that different regulators and government agencies will share information among themselves about an organization's compliance with subpoenas or requests for production, and (iv) the reality that the regulator requesting the documents will not have a reciprocal obligation to produce documents, and thus it has less of an incentive to negotiate a solution that would reduce the burden and cost of the production.

In practice, if not in form, neither the Federal Rules of Civil Procedure nor their state rule counterparts govern most requests from regulators, and an organization's ability to seek relief from unduly burdensome requests, is limited by its fear of appearing uncooperative during a regulatory investigation. It is with these challenges in mind that an organization must prepare for, and comply with, requests for production in connection with regulatory investigations.

When conducting an investigation, regulators are often focused on recurrent issues that have arisen in many of their prior investigations. An organization should be aware of, and prepared to address issues such as:

- Inadequate systems or procedures exist to ensure the retention of information that needs to be preserved
- Difficulties in timely retrieval and production of relevant data

- Insufficient coordination between legal and IT personnel in preservation efforts
- Reliance on individual personnel to preserve ESI without proper guidance, training or supervision
- Information that is lost when individuals leave the organization
- Relevant data that is unknown to the organization
- Backup tapes that are incorrectly identified as “unavailable” when they are available or in offsite storage facilities, or are represented as being overwritten when they have not been
- The existence of large volumes of email on file servers and backup tapes that have been taken out of service but not yet overwritten

E-Discovery Risks in Regulatory Investigations

The most serious risk associated with an organization’s response to a regulatory investigation is the inadvertent destruction of information, which a regulator may view as a failure to cooperate or, even worse, as a willful attempt to obstruct an investigation. Therefore, organizations must endeavor to preserve relevant ESI in connection with any such investigation. Keep in mind that regulators often have a variety of mechanisms available to them to enforce preservation obligations.

For example, there are harsh criminal obstruction of justice laws, both federal and state, that can apply when an organization does not preserve documents when responding to a regulatory investigation. The possibility of obstruction of justice charges for knowing or willful destruction of ESI is a powerful motivator in driving an organization to proactively manage and address the preservation and collection of ESI. In addition, regulators have used the record-keeping requirements of the Securities Exchange Act of 1934 as a means to ensure the preservation of documents relevant to an investigation.

The SEC has aggressively pursued violations of those record-keeping rules through enforcement actions, including violations discovered in connection with an organization’s response to requests for production of ESI. Similar, but less comprehensive, record-keeping rules have been enacted for the accounting industry under the Sarbanes-Oxley Act, and have been created by Title VII of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act.

Best Practices for Managing ESI in Regulatory Investigations

Effective planning and appropriate disclosure is the key to satisfying regulators that an organization has complied with its preservation and production obligations. If a regulator is satisfied that an organization is attempting, in good faith, to comply with its request, the regulator may be more willing to negotiate limits on the preservation and production obligations to help the organization manage the costs and burdens of compliance.

Formulate a Preservation and Collection Plan. Prior to receipt of a specific regulatory request for production, identify key data sources for ESI and develop a plan for the proper preservation and collection of data from those sources, including custodian data, organizational data and data from disaster recovery systems.

Document Preservation and Collection Efforts. The best way to convince a regulator that appropriate steps have been taken to preserve and collect relevant data is to be able to explain to the regulator exactly what steps were taken. Carefully documenting the organization’s efforts to implement its preservation and collection plan will put the organization in a position to provide

immediate and accurate answers in response to a regulator's questions.

Anticipate Second Requests. It is common for regulators to issue second requests for production after the initial production has been completed. It is good practice to anticipate the possibility of a second request and to consider during an initial review and production which data, if any, may be useful for later production in response to a second request.

"Meet and Confer" with Regulators. Even though there is no rule or regulation that imposes an obligation to meet and confer with a regulator, regulators are often open to such meetings. Upon receiving a preservation letter or more formal subpoena, an organization (or its counsel) should immediately engage in a dialogue with the regulator about the steps that the organization is taking to preserve and produce ESI. Any burdens or impediments to effective compliance should be raised as soon as possible, if for no other reason than to demonstrate that the organization intends to cooperate with the investigation

Be Aware of Production Guidelines. Many regulators have specific guidelines for production. Compliance with such guidelines is presumed, and organizations and their counsel must be cognizant of them. Any burdens or challenges of meeting the production guidelines should be raised during the meet and confer with the regulator.

Negotiate. It is possible, and advisable in most cases, to negotiate the scope of preservation and production with a regulator. Keep in mind that regulators often have staffing or budgetary limitations, as well as time constraints, that impact their ability to review large volumes of data. Counsel for an organization should be prepared to discuss scope limitations on the preservation and production to the most relevant ESI, which may reduce the costs of compliance.

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