

Bank Fraud & IT Security

REPORT

Prepared by
Southeast Consulting, Inc.



Proactive Discovery: A New Imperative for U.S. Banks

by Ursula Talley, StoredIQ

In the face of market turmoil, financial services leaders are accelerating their move to control exposure and manage risk, before regulators, prosecutors, and Congress arrive with the next round of investigations, audits, and subpoenas. Banks and thrifts of all sizes are now facing increased litigation risks and costs. More and more banking managers are learning that a great way to reduce those risks and costs is by adopting a *proactive eDiscovery* approach.

This article touches on the trends that make proactive eDiscovery inevitable, prescribes how to implement a proactive solution that can save your bank money, and profiles how to get started now.

Assessing the Stakes. What is at risk? Legal experts speculate that any institution with significant exposure to the subprime mortgage market might well find itself tested with cases involving wire fraud, mail fraud, securities fraud, and bank fraud, as well as violation of New York’s Martin Act, and The Continuing Financial Crimes Enterprise Act.

“Implementing a proactive eDiscovery strategy has to be high on the priority list of *every* enterprise,” says Deni Connor, founder and principal analyst at Storage Strategies NOW. Ms. Connor recently cited a study showing that large U.S financial institutions concurrently manage 556 litigation cases on average, with some 50 new disputes emerging each year. However, the need for strong, proactive eDiscovery processes is swiftly becoming an important *imperative* for organizations working in the financial services sector, simply because of the rapidly and growing risks.

Whether legal challenges are ultimately ruled legitimate or not is rather irrelevant. Challenges will happen, and they will be expensive. A more pragmatic way for financial institutions to avoid the litigation nightmare is to assess their risk exposure and take proactive control of their documents and eDiscovery

Table of Contents

- Early Detection of Potential Fraud and Mismanagement 1
- Controlling Money Laundering and Mortgage Fraud. 2
- Proactive Discovery:A New Imperative for US Banks.. 5
- 2008 Article Index Insert

Editorial Board:

- Frank W. Abagnale**, *Abagnale & Associates*
- Rich Bach**, *Principal, Deloitte & Touche LLP*
- Tom Bartolomeo**, *Senior Vice President, Information Security, Wachovia Corporation*
- James Bauerle**, *Esq., Legal and Fraud Prevention Services, Keevican, Weiss, Bauerle and Hirsch*
- Dr. Bill Chu**, *Chairman, Department of Software and Information Systems, University of North Carolina at Charlotte*
- Robert Dinsmore**, *Audit Committee Chairman, American Community Bancshares*
- Steve Hasty**, *Partner-in-Charge, Regional Risk Advisory Services, KPMG,LLP*
- Jim Mathews**, *SVP/Bank Security Officer, Fifth Third Bank*
- Robert Siciliano**, *President, IDTheftSecurity.com*
- Ralph Summerford**, *Partner-in-Charge of Forensic Accounting and Fraud Examination Services, Forensic/Strategic Solutions, PC*

A.S Pratt & Sons

2008© ALEX eSOLUTIONS. All rights reserved.
The ALEX eSOLUTIONS logo is a trademark, used herein under license.

Need more information on specific topics?

- Call:** 800-572-2797
- E-mail:** info.pratt@aspratt.coml
- Visit:** www.aspratt.com

processes before the regulators and Federal and state prosecutors arrive on their doorstep.

Getting Organized. In some cases, eDiscovery practices involve the rather complicated tasks of organizing and

tagging enterprise information for easy access. This means taking advantage of intelligent technology to provide your bank's legal team with a much smaller subset of relevant information for final review than they typically receive today. In other cases, proactive eDiscovery includes a process that disposes of old documents that your bank is not legally required to keep.

Using proactive eDiscovery to limit the number of documents subject to legal review cuts risk in two ways. First, it puts out of reach vast quantities of information that could be potentially damaging to your institution if you have chosen to keep it when you do not have any legal need to do so. Second, proactive eDiscovery *slashes* the costs imposed on your legal team!

Some experts claim that on average it costs \$1,800 per gigabyte to process and prepare data for analysis, and \$250 per hour to analyze and review it. Of the mountains of data analyzed today, only 20 percent ends up being relevant.

Moreover, effective proactive eDiscovery techniques focus on understanding how to produce the smallest legally defensible dataset should your financial institution be faced with a litigation-related eDiscovery request.

Understanding the Discovery Process. *Discovery* is the legal process that all organizations facing lawsuits are required to go through in order to produce relevant documents for the court. Generally, any company with \$1B in revenue will face multiple legal challenges on a regular basis. These legal challenges may be spurious or legitimate but, for most U.S. financial institutions, they are inevitable. What is notable is that the average U.S. financial institution spends between \$2.5 million and \$4 million a year on legal discovery of electronic files alone.

What is driving those costs? Part of this cost escalation is the sheer increase in the number of lawsuits. A component of these rising costs is attributed to the new regulations that enterprises have to comply with in the wake of Enron, WorldCom, and Tyco. However, a key factor driving this increase in legal discovery costs is the rapid growth of electronic data that is generated and stored by financial institutions as part of their ongoing business operations.

While technology has made our lives at work easier and more productive, it has also contributed to the proliferation of electronically stored information (ESI).

To make things even more complicated, as much as 90% of all of that information is unstructured and unmanaged. Most U.S. banks and thrifts do not have well-defined information management policies in place to manage the explosive growth of this data. This is often a recipe that can lead to huge litigation costs when financial institutions are forced to dig through mountains of information to provide timely responses for litigation discovery requests.

Couple the explosive data growth with the new Federal

Rules of Civil Procedure (FRCP), and it becomes increasingly apparent that all companies must focus on effective data management. UBS Warburg and Merck learned this painful lesson when they were forced to pay \$29.2M and \$253M respectively for non-compliance in litigation that required eDiscovery of documents. Clearly, the new FRCP rules, unlike many other compliance rules, are being *enforced*.

The eDiscovery Process. eDiscovery is the process of using technology to identify, collect, preserve, process, review, and produce all of the ESI that is relevant to a particular legal matter. *Reactive* eDiscovery means waiting until you face a legal matter, and then scrambling to ferret out data which may be scattered around the enterprise. *Proactive* eDiscovery, on the other hand, means putting processes in place in advance to classify, organize, and manage information to assure that your financial institution can respond quickly and easily at a much reduced cost.

Effective Record Retention Policies. A crucial component that significantly reduces a financial institution's future risk and cost is to dispose of old and obsolete data that the bank is no longer required to retain. Additionally, a proactive approach also helps you assess your bank's risk before the first discovery meeting with your opposing counsel.

The first part of smart records management is to establish retention and deletion policies in line with your corporate or industry-specific compliance mandates. The next step is to leverage information management technology to establish data topology reports, and automate policy enforcement across all data sources enterprise-wide. This might be something as simple as a policy about when to delete records so that they no longer become a corporate liability. Case in point: After a large legal case, DuPont conducted an analysis and found that 50% of the documents reviewed were kept beyond the required retention period. While the corporation had a policy in place, they did not enforce it. DuPont estimates it cost \$12 million to have attorneys review all of those old documents. These were old documents that would not have had to have been reviewed if the company had only followed their own policies.

Financial institutions need good records management policies that systematically expire and purge obsolete documents. Reducing the overall storage content not only reduces storage cost, it has a direct cost savings impact on eDiscovery tasks that arise at a later date.

When your bank can react faster and more intelligently, you have a significant strategic advantage over the opposing party in any legal matter. Moreover, an important benefit associated with proactive eDiscovery is the fact that you can leverage what has been gained through effective information management, which can

include the following elements:

- Organized storage resources.
- Reduced the number of redundant information *silos* across functional departments.
- Compliance with industry-specific regulations such as SEC Rule 17a-4 and Sarbanes-Oxley.
- Strengthened human resources in managing discrimination or sexual harassment.
- Better management of executive committee goals for Six Sigma realization.
- Guidance for IT management in identifying unapproved or inappropriate material that has been downloaded to corporate servers.
- Being ensured that intellectual property is safe and protected.

Moving from a Reactive to a Proactive Approach. The vast majority of U.S. financial institutions are still *reacting* to eDiscovery requests. Given the benefits of proactive eDiscovery, however, and the growing awareness of those benefits, it is not a question of *if* the majority of U.S. banks and thrifts will adopt a proactive approach, but *when*. The tipping point is rapidly approaching. See Exhibit 1.

So how do you prepare? How can your bank move from treating each discovery request as an ad-hoc reactive project to adopting a business process that embraces eDiscovery as a best practice?

Proactive eDiscovery is litigation readiness. To be proactive, you need an approach that takes into consideration both best *information management* practices and best *eDiscovery* practices. The two concepts are interrelated, and a proactive approach to eDiscovery integrates both.

Effective information management includes the ability to classify and index all data, especially unstructured, electronically stored information. Your bank's goal must be to quickly identify and retrieve relevant information.

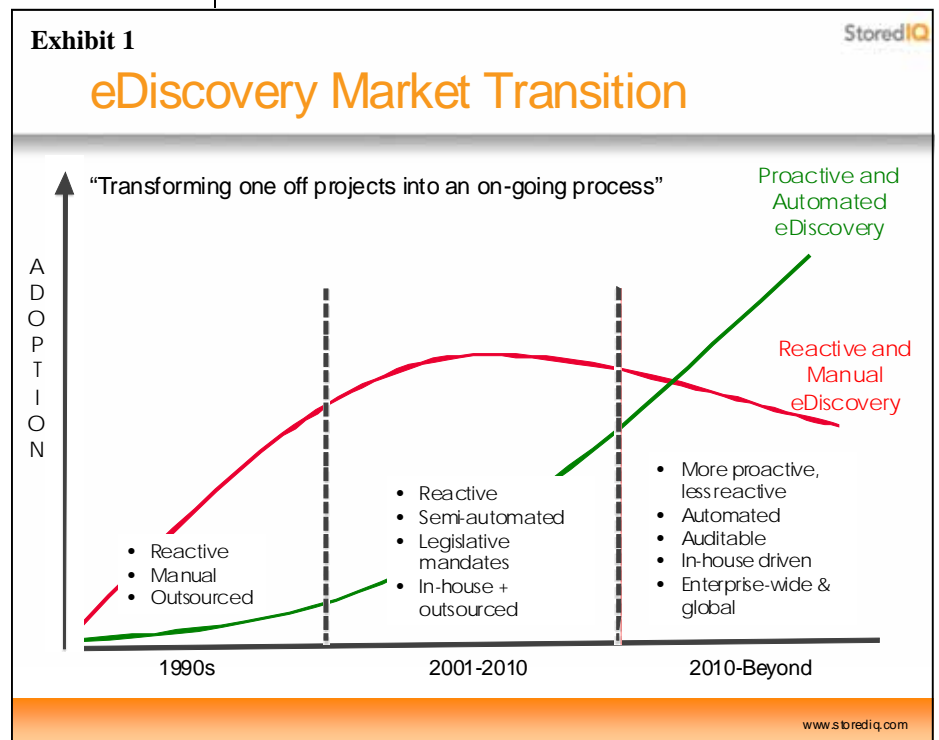
eDiscovery Best Practices. Eighty percent of eDiscovery cost, according to industry analysts, is incurred during the legal review process. For this reason, it makes sense to drive down the volume of data you send to attorneys who charge \$350 an hour to review information. Your bank's goal must be to collect only the smallest legally defensible dataset.

Here are some other things a smart eDiscovery process should take into account:

- **Data Ownership.** Know your data custodians. One of the biggest problems

many organizations have when facing eDiscovery requests is that they do not know where the data is, how to find it, or who owns the data. Accordingly, your bank should map your data to expedite identifying target custodians prior to collection and preservation.

- **Data Location.** It makes a big difference if your data is readily available versus having to retrieve the data from backup tapes. Do not walk into a required eDiscovery *meet and confer* session with the opposing counsel without knowing where your data resides. Again, data topology mapping helps you analyze your ESI and preserve the *right* amount of ESI without over-preserving unnecessary data.
- **Data Delivery.** Is it easier for you to present tons of printed material, or a clearly grouped set of PDFs or Tiff files? How is your current data stored, and what effort and process is required to expeditiously retrieve the data? If you have a handle on this, you are much better prepared to assess how much time, effort, and money an eDiscovery request will cost. Armed with this information, your bank will be better prepared to negotiate terms with the opposing counsel during the *meet and confer* sessions.
- **Managing Keywords.** When you meet with opposing counsel during the initial *meet and confer* session, one of the things you will decide on is what keywords you will agree to use to search through data that you will produce for the court. Be prepared! If you know that a certain keyword is vague and will call up volumes of data, much of it extraneous, and all of which will have to be reviewed by the \$350 per hour lawyers, then you are in a good position to negotiate that it not be included. The best eDiscovery solutions allow you to create *what if* scenarios that you can use to scope out the range and breadth of data before you go into the initial *meet and confer* session.



Today most eDiscovery is still reactive, but that's changing fast

Consider a worst case scenario, which unfortunately happens all too often in today's reactive eDiscovery world. For example, your counsel walks into a *meet and confer* session unprepared. He agrees to produce data without knowing where the data is. He agrees without knowing who the data custodian is. Additionally, he agrees to keywords, the scope of which is unsure, and what sort of data mass those keywords will produce.

The result? It may often turn out that he will agree to produce data, which is archived on backup tapes, and bringing that data back online and searching it will be laborious and expensive. Further, he may agree to produce data using a wide variety of keywords. Those keywords might call up thousands of pages of documents, all of which both teams of lawyers will have to review. He might agree to produce things in an electronic format that his company has limited or no capability to produce, and that will require expensive investments he had not foreseen.

Conclusion. Proactive eDiscovery requires putting in place intelligent information management strategies to assure that you know where your bank's data is located, how it is organized, how to access it, and when to automatically delete it. The effective deployment of these strategies constitutes world class eDiscovery. The leverage of these intelligent information management practices will help your bank navigate the treacherous litigation waters the U.S. banking industry is sailing into today.

Ursula Talley is vice president of marketing for StoredIQ, a leading provider of enterprise-class Intelligent Information Management solutions that enable organizations to gain visibility and control over business-critical information in order to meet compliance, governance, and legal discovery requirements.
www.storediq.com

The logo for StoredIQ, with "Stored" in grey and "IQ" in orange.

**This reprint is made with the permission of
A.S. Pratt & Sons**

2008© ALEX eSOLUTIONS