Rabid Regulators Want Your Hide

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Financial institutions continue to collapse or teeter toward the brink. Others are rumored to be shaky or could become that way in the weeks, months, and years to come.

What are the implications for people who are dealing with these institutions or who might choose to deal with them before the government closes them down?

The answer is scary, and it applies to banks, savings and loans, savings banks, and credit unions alike:

Nobody is safe, and you deal with such institutions at your peril.

As a financial institution approaches the brink, it naturally calls upon lawyers and accountants to advise it in staving off a potential collapse or takeover.

Certainly members of management want to save their hides - and hope to save the institution in the process. However, once it ceases to exist - or is "reborn" with a new owner and different managers - the former players are ripe for government lawsuits. Short Coverage

After the write-down of real estate and other assets by the regulators, there are probably enough legal causes of action to fill a lengthy complaint.

The institution's former lawyers should look at their malpractice coverage and the accountants at their potential risk exposure. Managers should read their directors' and officers' liability policies very carefully.

Chances are that the coverage won't be adequate and that some level of self-insurance may have already taken place.

Moreover, as the recent Kaye Scholer/Lincoln Savings settlement indicates, the government may be after more than just all of the insurance proceeds available. (The law firm of Kaye, Scholer, Fierman, Hays & Handler agreed to pay $41 million.)

The regulators and their outside attorneys may also seek personal assets in an amount several times a law firm's capital accounts. Partners who did not have the foggiest idea of what a financial institution was may find themselves contributing handsomely.

And who are these culprits that the government so dearly loves to hate? Probably officers, directors, lawyers, and accountants who did what any reasonable man or woman might have done, but who just happen to have deep pockets - extended by their insurance carriers' pockets - that the government would love to pick.

And why is this happening? Because with all of the recent financial institution collapses and the red ink gagging just about everyone in the country, there have to be scapegoats. Congress is trying to deflect attention from itself, and the regulators are just trying to do their jobs and keep Congress off their backs.

It's a vicious cycle even where no criminal conduct is present; and it is clear that economic hard times have contributed to these results.

What about employees and others who would deal with an institution that few know is actually collapsing?

They're at risk, too.

The government is seeking to repudiate vested employment rights, not just prospectively but also any that were earned and accrued and shown on the institution's books before the collapse.

Why should any employee feel safe under these circumstances? The answer is that none should, especially where sizable amounts of money are involved and the whims of government regulators are present. Time to Flee

In such an environment, is anyone safe? Not many. The best rule, I'm sorry to say, is to bail out of a failing institution as early as possible.

"What if we can't," you ask, "either because the institution's true financial condition isn't known or we're too locked in for one reason or another?"

If you're a manager, check your employment contract carefully and try to renegotiate it if necessary. If you're a director, check your insurance coverage carefully and demand more insurance - or resign. (Even if the coverage seems adequate, more knowledge of wrongdoing may be ascribed to you than you probably have.)

So hold onto your pocketbook. The government may come looking for it.

In the case of managers of profitable subsidiaries who think they're immune and their benefits are safe, forget it. When the government repudiates contracts, yours may be among them. And when the government looks for scapegoats, you may be on the list.

It doesn't matter how clean you are or how well your shop was run. The regulators in charge may not care.

Plus, they're often jealous of the salaries that were earned. They even hire disgruntled former employees to help them sift through the carnage and decide who gets fired and who stays. Risky Business

If you think I'm kidding, ask a few of your compatriots who've been through the experience.

With respect to the lawyers involved, it's a risky business representing financial institutions these days. Just talk to the partners at Kaye Scholer.

Despite what the regulators say and what their attorneys will argue in court after the institution goes under, most lawyers and law firms are as much in the dark concerning the institution's true financial condition as are its depositors and the general public.

Also, lawyers and accountants work for management on a day-to-day basis. If a lawyer or accountant ever said he or she was going directly to the board of directors, the next lawyer or accountant would be there in a wink, as a replacement.

While professionals have duties to the board, practicalities govern daily actions. However, today the regulators are saying that these duties run directly to them, instead of just to the institution.

Also, beware of conflicts of interest. Regulators who find them will truly eat you alive.

In short, managers or directors or lawyers or accountants who fail to "rat" upon learning of possible wrongdoing do so at their peril. If the government wants your personal assets, to teach other people a lesson, no amount of malpractice coverage will be adequate.

As for the accountants, when was the last time they refused to bend the rules or try to fit a square peg into a round hole at some large client's behest?

Again, the rules are changing. But one thing is certain: The government is looking for deep pockets, and it is not stopping where it used to.

Like the zealots of the legal profession who have made the lives of most doctors a lot less enjoyable, the government's lawyers are seeking to expand their theories of recovery with each lawsuit that is tried.

But don't professionals have a duty to serve those in need, including failing financial institutions?

True, but that argument will only go so far when case after case - or settlement after settlement - produces results that in no way reward good samaritans.

What's the answer? Stay clear of lots of financial institutions at all costs?

Maybe. That may be the only wise thing to do if the regulators and their legal zealots have their way, and if sympathetic courts continue to think the government is always right.

If, however, a rule of reason begins to emerge that says not everyone involved with a failing financial institution is necessarily a crook, then the climate might change for the better.

Right now it's wise to be conservative, especially if lawsuits aren't music to your ears.

In fact, some disputes in this area could be resolved by an administrative process. However, no such process has been established, except on a pilot basis, even though the ink has been dry on the Financial Institutions Reform, Recovery, and Enforcement Act for almost three years.

Finally, what about depositors?

Make sure that every dollar invested is fully covered by federal deposit insurance, and don't deposit any monies beyond these insurance limits.

While the uninsured portions of large deposits are sometimes paid off - certainly when a failed institution's deposits are sold to a healthy competitor - that isn't always true.

Ask a widow or a husband and wife with all their savings in a failed institution. Or ask a financial institution that carried large balances at a bank that went under. The horror stories are enough to curl one's hair.

The only answer is to place your deposits at multiple institutions, and then only up to the federal insurance limits.

Is anybody safe? Not at the moment, I'm sorry to say. These are perilous times for those who deal with financial institutions - and I haven't even touched on the problems confronting borrowers.

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