DIRECTORS ROUNDTABLE

WORLD RECOGNITION of DISTINGUISHED GENERAL COUNSEL

GUEST OF HONOR:

Richard E.T. Bennett

Group General Manager,
Legal & Compliance of HSBC Holdings PLC

THE SPEAKERS:

Richard E.T. Bennett
Group General Manager, Legal & Compliance, HSBC Holdings PLC

Victor Lewkow
Partner, Cleary Gottlieb Steen & Hamilton LLP

Winthrop Brown
Partner, Milbank, Tweed, Hadley & McCloy LLP

TO THE READER:

General Counsel are more important than ever in global affairs. Boards of Directors are looking increasingly to them to enhance financial and business strategy, compliance, and integrity of corporate operations. In recognition of our distinguished Guest of Honor's career accomplishments and of his company's valuable contributions and leadership as a corporate citizen, we are honoring Richard Bennett, Group General Manager, Legal & Compliance of HSBC Holdings PLC. His address will focus on the challenges facing the General Counsel of a financial institution operating in 83 countries with differing regulatory and legal systems. The Panelists' additional topics include mergers & acquisitions, and financial institution regulation. The transcript of this event will be available worldwide in electronic copy.

The Directors Roundtable is a civic group which organizes the preeminent worldwide programming for Directors and their advisors including General Counsel.

Jack Friedman
Directors Roundtable
Chairman & Moderator

Richard E.T. Bennett

Group General Manager,
Legal & Compliance,
HSBC Holdings PLC

HSBC
The world's local bank

Richard Bennett was born in 1951 and is married with two sons. He graduated in 1973 from Bristol University and worked with Stephenson Harwood & Tatham (now Stephenson Harwood) in London from 1974 to 1979, being admitted as a solicitor in 1976. During that period he was seconded for a 6 month period to a client, The East Asiatic Company in Copenhagen. In 1979 he joined The Hongkong and Shanghai Banking Corporation in Hong Kong as the junior member of the three person legal team. He was promoted to Deputy Group Legal Adviser in 1988 and to Head of Legal & Compliance for Asia Pacific in 1993. He moved to his present role as Group General Manager, Legal & Compliance for HSBC Holdings plc in January 1998 and now has responsibility for Legal and Compliance throughout the HSBC Group who now employ over 950 lawyers, including paralegals across the world and more than 2,500 Compliance Officers. He serves on various external committees in the UK and his interests outside the workplace include sport (rugby, football, and golf) and wine.

HSBC

HSBC is one of the largest banking and financial services organizations in the world, with a market capitalization of USD198 billion at 31 December 2007. Through its subsidiaries and associates HSBC provides a comprehensive range of banking and related financial services. Headquartered in London, HSBC operates through long established businesses and has an international network of more than 10,000 properties in 83 countries and territories in 5 geographical regions: Europe; Hong Kong; rest of Asia Pacific, including the Middle East and Africa; North America and Latin America. Within these regions a comprehensive range of financial services is offered to personal, commercial, corporate, institutional, investment and private banking clients. Services are delivered primarily by domestic banks, typically with large retail deposit basis and consumer finance operations.

JACK FRIEDMAN: Good morning. The background of this special event arises from the following: Over the years, I've had many discussions with Directors of corporations all over the world. There's a feeling that modern corporations don't get positive credit for the good that they do, whether they create jobs, pay taxes, create new products, or any other contribution that they make. It is very important for the community to know more about the corporations, and also to get to know some of the famous executives who they made read about in the financial press. I want to thank Richard Bennett, the global General Counsel of HSBC, for accepting our invitation to be our Guest of Honor. The Distinguished Speakers are Victor Lewkow of Cleary Gottlieb Steen & Hamilton and Winthrop Brown of Milbank, Tweed, Hadley & McCloy. The format will be that our Guest of Honor will speak first, then we'll have the two panelists speak, and have a Roundtable discussion. Finally there will be interaction with the audience.

We don't view this as a "press conference" format, where it's question and answer, question and answer, during the discussion period. So if somebody has an insight or experience that they'd like to share, that would be fine. There's so much high-powered expertise in the audience that we should get the benefit of the guests here.

I'd also like to thank Mr. Bennett's wife, Helen, for joining us this morning, and we have other family here, too. I asked Helen about her shopping. Apparently the pound is favorable, but it is not quite good enough for her to be able to go into a store and, with one swipe of the credit card, just buy out the whole store. But she is able to contribute to our economy, and on behalf of Mayor Bloomberg and everybody else in New York, we want to thank her and her husband for doing their shopping here.

Without further ado, our distinguished Guest of Honor.

RICHARD BENNETT: Good morning, ladies and gentleman, and thank you, Jack, for that expensive introduction.

Thank you also, very much, Jack, for inviting me to the Yale Club this morning and honoring me. It is a great honor.

I'm grateful to all of you for taking time today to come to the Yale Club. You have busy diaries, and it's an extremely warm morning. It's great to see such a big turnout. I'd also like to thank my panelists, who I've worked with for many years, for their support and also for coming today.

Jack has asked me to speak on the subject of the challenges facing the general counsel of an organization such as HSBC, operating in 83 countries, each with

differing regulatory and legal systems. However, before I do so, may I give you a little background on the HSBC Group which may not be known to many of you. I hope to my colleagues present that this will be old news. I will also give you a little bit about myself, as it is relevant when I consider those challenges.

First, if I could begin with a little bit of history about HSBC. Parts of the HSBC Group can trace their history back to 1762. However the founding organization, The Hongkong and Shanghai Banking Corporation, or "the Bank", as we like to refer to ourselves, was incorporated and opened for business in Hong Kong and Shanghai in 1865. The Bank was established to facilitate trade to and from Asia, and established its first presence in the United States in San Francisco in 1875, following improvements in the shipping services across the Pacific. A branch in New York followed shortly thereafter in 1880. So we've been here for some time.

Up until 1980, the Bank maintained a relatively small presence in the United States, with branches, agencies and representative offices, and also the Hongkong Bank of California, which was established in 1955 and in fact was the Bank's first commercial banking subsidiary anywhere in the world. It was formed to meet regulations and to be able to accept deposits. We did, however, close it in 1980 as a consequence of what I'll mention next.

In 1978, the then-chairman of HSBC, commissioned Booz Allen to look for target companies to acquire in the United States in order to expand out of Asia. In 1980, The Hongkong and Shanghai Banking Corporation acquired a 51% interest in Marine Midland Banks, Inc., and acquired the balance in 1986. In 1999, we acquired Republic National Bank of New York, and in 2003, Household International.

Today, HSBC has a presence in almost all states across the United States, with HSBC Bank USA, which is the successor of the combined Marine Midland and Republic, having approximately 470 offices, while HSBC Finance, the former Household International, has over 900 offices.

So that's the U.S. profile.

Out of its Asian roots, HSBC has grown substantially, particularly over the last 30 years. Today, through more than 1,600 subsidiaries and associates, HSBC provides a comprehensive range of global banking and related services. Headquartered in London, HSBC has an international network of more than 10,000 offices in 83 countries and territories, and divide itself into five geographic regions, being Europe, Hong Kong/China, the rest of Asia/Pacific (including the Middle East and Africa), North America, and Latin America. Within these regions, a comprehensive range of financial services are offered to personal, commercial, corporate, institutional, investment, and private banking clients. I think the American expression is "soup to nuts" of clients.

HSBC has grown organically, but also by a series of acquisitions of locally incorporated banks, and Marine and Republic are two examples here. As a result, services are delivered primarily by domestic banks typically with large retained deposit bases; hence, our strapline, "The World's Local Bank" – we live what we are. Staff numbers have risen to in excess of 320,000, and thanks due in part to the effect of the current credit crunch, HSBC is today the third largest financial institution in the world, by market capitalization, behind two Chinese banks.

Enough of HSBC's history, and turning to myself, I qualified as a solicitor 32 years ago (and sometimes it

feels like it!). While I found my English qualification has been very useful in helping me meet the challenges of my current role, there are two other important influences in my life before I joined the Bank in Hong Kong in 1979. The first, I spent my childhood in Asia. This gave me a wide perspective of different people and cultures, which is very important to the role I now fulfill. Secondly, I was seconded the year after I qualified to work with The East Asiatic Company, then the largest trading company in Denmark, with a substantial international presence. My time with this large international company gave me a taste for being an in house lawyer, but also the experience of dealing with issues in a wide variety of jurisdictions.

When I went to Hong Kong in 1979 to join the Bank, it only had one legal department anywhere in the world, comprising two lawyers, and I became number three. Being the most junior person in a small department, there was plenty of opportunity for me to gain experience on a very wide variety of issues arising in many countries. Today, HSBC has legal departments in 53 countries, and the legal headcount, including paralegals, has risen to more than 950.

I also have responsibility for compliance. Thirty years ago, the word "compliance" did not exist in a banker's vocabulary, but today, we have more than 2,500 compliance officers within HSBC, and they are in every company and business in which we operate. While legal and compliance headcount remains approximately 1% of HSBC's global workforce, I do have a lot of colleagues available to help me, and this is one of the keys to meeting my challenges.

I can see some of you wondering, what 950 lawyers do within HSBC? The simple answer is that we operate as if we were a law firm. We aim to facilitate business transactions while controlling legal risk. While HSBC remains heavily reliant on external legal support, particularly when the customer is paying, in house lawyers will typically be involved in a variety of matters which range from corporate transactions, whether large and newsworthy or the more straightforward internal reorganizations; negotiation of contracts of all shapes and sizes, as well as settling template agreements for more routine matters. We manage a portfolio of litigation against HSBC, which includes nearly 80,000 cases where HSBC is a defendant in Brazil, and that is below the industry average, so I'm afraid the capital of litigation is not in the United States. We also protect HSBC's intellectual property rights through patent and trademark registrations, as well as dealing with numerous daily inquiries.

In my case, the extremes of matters in which I've been involved range from advising a young executive who had been detained by the police overnight, allegedly for indecent exposure in the red light district of Hong Kong – I'm pleased to say the charge was never proven – to involvement in multibillion dollar corporate transactions.

Focusing primarily on my legal as opposed to my compliance responsibilities, what do I see as my principal challenges? I've identified five; first, moving from being a legal advisor to a trusted advisor. I've always felt a little jealous of my counterparts at U.S. financial institutions because of their very close relationship with senior management in their organizations though I suspect such relationship may be driven primarily by the litigious environment in the United States. The historic British model that exist in many organizations, including HSBC, was to look to lawyers purely for legal advice when the business wanted it, and often not quite sure what question they should ask. This model simply does not make the best use of in house lawyers, who have much more to offer. Thankfully, following on from my attendance at board and executive committee meetings of HSBC Holdings, HSBC's in house lawyers should now be able to have a seat at the table, and are there to give not only legal advice, but also advice on reputational issues arising from business proposals. No company today, particularly in the financial services industry, can take risks with reputation, and therefore much time is spent persuading business colleagues to ensure that they involve lawyers as early as possible in all business transactions. By doing so, they should avoid conflict between the business and the lawyers which has arisen in the past, when a lawyer is asked to sign off documents with which they have had limited prior involvement and there is no time to renegotiate.

The second is legal risk management. Management and mitigation of legal risk have always been a key responsibility for a legal department. This is even more important today in a financial institution, with adoption in most countries of Basel II. This requires capital for the first time to be placed against operational risk, which is defined to include legal risk. Historically, HSBC has not suffered substantial loss arising from legal risk, but the focus introduced by Basel II, coupled with the increased oversight from regulators on internal control within financial institutions, has led HSBC to move towards being far more structured in how it identifies, measures, mitigates and then tests controls over legal risk.

In an organization offering the complete spectrum of financial services in many jurisdictions whose laws may be based on common law, civil law, Roman Dutch law or a combination of any of them, managing legal risk is a substantial undertaking, especially when it is essential that whatever procedures are introduced to control legal risk do not become a substantial impediment to the profitability of HSBC.

Within HSBC, we have for a number of years defined legal risk as one of contractual, litigation, intellectual property, or legislative (or change of law) risk. Some of these risks – for instance, handling of litigation and monitoring change of law – are entirely the responsibility of the legal function, whereas others require the lawyers to work closely with the business to mitigate that risk.

While taking care not to have too many procedures, the legal function is constantly working with the business to identify new areas of risk, often learning from the experience of other finance institutions, and introducing controls to manage those risks and even other legal risks which may have existed for some time but for which there is not adequate control. The risk assessment methodology adopted is the same as that HSBC uses for all operational risks. Hopefully we avoid putting in too many procedures and controls and thereby impacting the business's ability to complete transactions. This area continues to be a work in progress within HSBC, and I fear that in the increasingly complex world in which we live, it may never be complete.

Third is dealing with the unpredicted or unexpected. Although its origins are uncertain, there is currently a well-used phrase and it may even be a curse, "May you live in interesting times." However, irrespective of its origins, it has never been truer in financial services during the last twelve months. Enhanced by the speed of communication through e mail, Blackberry, and diligent news services every day bring something new – probably in the last ten minutes. Within HSBC, we have a very clear philosophy that it is more of an offence not to report an issue up the line than it is to have some new material litigation or regulatory breach, or whatever else may be affecting a part of HSBC.

Within the legal function, I've introduced what is now known as the "cornflake test". Put very simply, it is a requirement that I must be informed of any newsworthy item, and be in a position to report to senior management before they choke on their corn flakes when they open their morning newspaper or log on to their e mails!

Whether it be some new substantial litigation or a regulatory breach, it is imperative that it is acted upon quickly. Equally as laws and regulations change, it is essential that steps are taken to ensure that HSBC continues to be in compliance with both the spirit and letter of the law.

I'm very fortunate that across the world, and especially in the jurisdictions in which HSBC has a large presence, including obviously the United States, I have colleagues who understand HSBC's philosophy and have the ability to act on events as they occur. They are very ably supported by external lawyers, some of whom are on the panel today and some of whom, I know, are in the audience. I would like to take this opportunity to thank all of them, and in the case of the external advisors, their firms, for the support they've given to me over the last 29 years.

My fourth challenge is joining up a global function. As I've already mentioned, HSBC employs over 950 lawyers spread over 53 countries. That's a lot of brain power. Functionally, they report to me, but their primary reporting line is to their country's CEO. As a result, individual legal departments are inclined to be very focused on the issues arising in their countries. So my challenge is to utilize this considerable expertise spread over a large number of lawyers, but also to ensure that the smaller legal departments – and only 13 of the 53 departments have more than ten lawyers – can benefit from the knowledge of their colleagues in other departments.

It's a challenge to make the whole greater than the sum of the parts, and I've introduced a number of initiatives. In particular, I've formed a Legal Executive Committee, which physically meets four times a year and has a conference call in the other months. In fact, we meet tomorrow in New York.

> "Thirty years ago, the word "compliance" did not exist in a banker's vocabulary, but today we have more than 2,500 compliance officers within HSBC."
> – *Richard Bennett*

Legal Exco comprises the regional general counsels for North America, Latin America, Europe, Middle East and Asia Pacific. Together with the general counsel responsible for Global Banking and Markets – that's our wholesale business – I look to this group to agree with me on common strategies for developing a global legal function, and then take responsibility for implementing those strategies in their respective regions or business.

In HSBC we've created global legal practice groups whose members are lawyers practicing in different jurisdictions covering respectively derivatives, cards, global capital markets, IT and IP, payments and cash management, security services, insurance, and Islamic finance. A high potential individual practicing in an individual area is asked to act as a convener for a practice group, reporting to a member of Legal Exco and these groups meeting physically, but more often speaking on the telephone, discuss common issues of best practice, as well as having specific objectives agreed with the relevant business to help provide greater support to them.

Knowledge management has not developed in house in the same way it has in private practice firms. While we do not need the sophistication of private practice, sharing knowledge is key. HSBC has had legal intranets for some time but is now in the process of developing regional intranets which will be interlinked so that we will soon create our own legal web. If my dream can be realized, a lawyer in Australia will be able to log in and access all the intranets around the group when most of their colleagues are asleep. The intranet will utilize both internal and external input, and we're making good progress. There are challenges in getting IT resources to develop them, and also in persuading colleagues of the benefits of sharing their personal knowledge. We're not there yet.

My fifth and last challenge is people development. The practice of law remains a people business. HSBC is in a fortunate position of being able to attract good lawyers from other organizations as our need arises. However, developing and thereby motivating staff is an ongoing challenge, as internal training within HSBC is historically on the financial services executives, rather than on specialists such as lawyers. There are ongoing needs to convert good lawyers into good commercially-thinking lawyers, as well as converting good commercial lawyers into good managers.

HSBC looks to offer secondment opportunities to persons we consider have high potential, either on a short-term attachment basis to cover absences such as maternity leave, or for longer secondment of up to three years. These secondments give the selected individuals an excellent opportunity to gain a great understanding both of the HSBC Group but also different jurisdictions and cultures. While there's always a challenge in persuading a lawyer that overseas opportunities would be good for their career, and there are often issues in finding a suitable position when they return to their home jurisdiction, our experience is that these opportunities are invaluable in developing our lawyers for the future.

I've given you five challenges as I see them, and I don't have a simple answer to the question of how I meet the challenges in my present role. However, I am greatly assisted in a number of ways.

I'm fortunate to have benefited personally from international exposure over many years. I would certainly not put myself forward as being qualified to advise outside my home jurisdiction of the United Kingdom or Hong Kong, but the experience I've had over my time with HSBC has developed a limited knowledge, particular in some core jurisdictions, which allows me to challenge advice being given if I don't feel it sounds right. As I read recently, differences between jurisdictions are often important in relation to the precise wording of the law, but can be over-egged in relation to legal practice and increasingly documentation. Globalization applies to us, as well.

I've been fortunate to work within an organization that has a strong collegiate and compliant culture. HSBC is a group with very little internal politics, and large personal egos find life difficult. Many executives like myself have spent their working lives with HSBC, so many colleagues have become personal friends, which lead to open and frank dialogue. Probably based on its Scottish origins, HSBC has also been inclined to be conservative, and not to challenge the law if there is uncertainty. I've heard very senior executives state that no transaction is sufficiently valid to HSBC if it could damage its reputation.

I'm fortunate to have colleagues based around the world that I can trust to keep me appropriately advised, to give me local advice, and to act in the best interests of HSBC. As our advertising material says,

"Local Knowledge is Key."

I hope this morning I've given you a small insight of some of the challenges which I face. I suspect these challenges would not be very different from those of other general counsel, and the only difference is probably the scale of HSBC in terms of breadth of business and its geographical reach.

Thank you.

JACK FRIEDMAN: Very good. Thank you. Before we go on to our other speakers, I just wanted to ask a couple of questions.

I'm not familiar with the concept of a reputation or reputational committee, which you have. Obviously, companies are concerned about their reputation. Could you tell us a little about the committee; how it's formulated; and why you have a formal committee?

RICHARD BENNETT: It's been an aspirational wish of mine for a number of years, but I can't give you, Jack, a very full answer, because it's only had one meeting so far. We do have a Reputational Committee. It's chaired by the head of Group Compliance, who is one of my reports, and it comprises a variety of very senior people ranging from the Finance Director, the head of H.R., the head of Public Affairs, the head of Risk, the head of Group Sustainability and to others I am sure I have forgotten. What it does is look at the risks that a group like HSBC faces, which are not purely financial. These are not ones that necessarily impact the balance sheet directly. So a combination of what may be a current focus for the press, what are we doing in terms of our regulatory relationship, what substantial newsworthy litigation do we have; all these come into the mix. I wouldn't say it's a drains up; it's a question of, well, we've got these risks, and where do we see something that we can actually act on now ahead of reputation being affected.

JACK FRIEDMAN: In the U.K., how does the public, press, governmental authorities operate versus in the U.S.? In the United States, there's the idea that somehow a banker is your personal family financial friend or relative, like your brother-in-law. Some people say, "Well he's my banker. He's supposed to do this and this and this for me, and he's charging me?"

RICHARD BENNETT: Well, if I can talk in a U.K. context, two comments: Bad news sells newspapers, and unfortunately, in my ten years of working back in the U.K., banks have not been everyone's most popular friend, i.e., current practices are not popular with the consumer lobby, who do not believe banks should be charging for services, and, "you should be giving a service to us for free and you shouldn't be making money from your customers." As a result financial institutions find themselves between a rock and a hard place of providing customers a service and so earning money from the customers, as against being as profitable as possible for their shareholders.

The popular press in the U.K. has a field day commenting on banks. Monday morning is never a good morning when the press cuttings come around, because you're looking to see if they've had a go at you or the industry, or they're having a go at another bank and it's not your turn.

The second aspect is the power of the internet, and I'll give you two examples. We recently changed a product for student loans, and through FaceBook, a group of customers got together people protesting outside our branches within 12 hours. They said, "This is a terrible company. Look what they've done to student loans." The message travelled like wildfire. That's the power of the internet.

Similarly, some of you may have read that there is an ongoing debate about overdraft charges in the U.K. An activist group booked themselves television time to publicize their claims, and anyone could go onto the BBC's website – it's not a private website – and download a form to send to their bank to claim back their supposedly illegal overdraft fees.

The internet is making it a lot easier for the public to have a go at banks through a combination of media pressures. The newspapers are not friendly to banks. We can never seem to do anything right, because if we did, it wouldn't be published. The internet is very intrusive. It aids communication and activities like form-filing.

WINTHROP BROWN: Good morning. I'm Win Brown with Milbank Tweed. Jack has asked Victor and me to speak in reaction to Richard's good speech.

Before I start, let me just say a word about Richard. As he says, he joined the HSBC Group, then the Hongkong Bank, 29 years ago, and it was at that time that I was a mid-level associate working on the recently enacted International Banking Act of 1978 which, for the first time, set rules on how foreign banks do business in the United States. I think, Richard, we probably met over a telex in those days. All of you are too young to remember, but those great big long pieces of yellow paper that came out of that machine was the way that one communicated with far-off places like Hong Kong in those days.

Richard had been assigned by the Group Legal Advisor at the time the task of reducing to a readable form a summary of how HSBC was going to be regulated in the United States, and it fell to me to be his colleague in writing that piece of writing, and it famously became known – you'll remember, Richard – as the "Child's Guide". And it was written for non-lawyers in order to introduce them to the crazy world of U.S. regulations. It was so successful, I'm pleased to report, that it was followed by two other editions: One was called the "Adult Guide", which was designed to educate lawyers about the American rules and regulations; and then my recollection is that the final version was called the "Idiot's Guide".

RICHARD BENNETT: We won't say who got that one!

WINTHROP BROWN: I could tell many stories about Richard, but I just want to say that while all of Milbank's clients are perfect and all of them are a pleasure to work with, no one is more perfect and more a pleasure to work with than Richard and his team. It's been a wonderful 29 years for me, and I want to congratulate you, Richard, on this award.

I thought I would say something about two subjects.

First, the role of an outside regulatory counsel on a one-time-only transaction. Victor and I most recently worked on the Household transaction together, and playing the regulatory role as external counsel is a little bit like cooking. You have to start things at the right time, but they've all got to come out at the right temperature at the right time at the end of the process. But the ingredients that go in do not necessarily order themselves in that way. The world is really divided in the regulatory realm between approvals that have to be obtained in advance, and those that require filings after the fact, notices to regulators about what has just happened.

In order to get something right on the kind of scale that HSBC is used to dealing in, the role of external counsel has a very important project management component to it. And our task was to set up with Richard a system whereby all of the regulatory approvals and filings that were required were listed, analyzed, and then monitored and managed in a way that produced the right result at the end of the process. So you would have an announcement of the transaction; it was contingent on the regulatory approvals being obtained; and we formed a committee that met by telephone from half a dozen different jurisdictions in the case of Household to list some eight or ten pages of different regulatory filings. Richard or his designee was a member; Victor or his designee was a member; and on the phone were counsel in all of these different jurisdictions, each reporting on the various elements of the task at hand.

One of the most interesting developments over the years is that with the coming of liberalization in the banking world with the Gramm-Leach-Bliley Act of 1999, federal approvals by and large have dropped off as a requirement. Those institutions like HSBC that are qualified do not have to get advance federal permission to do most of what they want to do in the United States. This gives rise to the increasing importance of state regulatory requirements, and only in America, of course, would you have 50 different jurisdictions, each of which has its own banking and finance laws, and the exercise I've described in the case of Household in particular brought all of this to the fore, and state regulations can be quite tricky. Each has to be analyzed; they all have their own idiosyncrasies; and companies like finance companies and mortgage companies, auto finance companies, can be very much at issue and require regulatory filings. There is the dreaded insurance company, which has tripped up many an acquisition in the past. You don't want to be the external lawyer who calls Richard early in the morning and says, "Every member of the board of HSBC Holdings PLC must have his or her fingerprints taken." That requires Richard to get them away from the villa on vacation and down to the local shop – not something they particularly want to hear.

Local experts are required in these kinds of situations, and this leads to an interesting quality control element to the task, because it's very often the case that the fellow on the ground who is your expert is truly expert and knowledgeable about that particular regulatory agency, but what you're as likely to get as anything is, "Don't worry; I had lunch with the commissioner, and he says it's just fine." That's not something you can really take back to the head office as the last regulatory approval necessary to go and buy Household International.

Turning to the relationship of outside regulatory counsel with a group like HSBC, on an ongoing basis, a couple of things occur to me as general points of interest. First, there is the question of who is the client. That's probably more starkly posed than I mean it to be. I am simply trying to highlight the fact that in the normal course of representing units within a group where the entire group, like HSBC, you'll very often be dealing with a business unit that has an idea, has a new product they want to launch; they come to you for advice, and they, after all, are paying your bill. It comes out of their P&L statement. And you're absolutely dedicated to making sure this product is a success. At the same time, over your shoulder, you have Janet Burak as head of North America. Mike Emerson is worrying about the bank and the broker-dealer. You have Richard sitting in London. What is the right way of introducing these people into the equation, and at what time?

Many business units or people who are at the cutting edge of what they're doing don't want to involve anyone up the flagpole in their organization until they're good and ready to do that. And one of the pieces that they have to get into place is the blessing of the lawyers that it works. So while it's not as strong as a divided loyalty by any means, it is a matter of skill to try and incorporate in the process advice to that, if you like, lower-tier unit within the organization, at the right time to bring things up the chain to the right legal and compliance people.

This flows both ways. There are instances in which you learn something important from someone senior, and could that information be helpful to the folks on the ground who are putting something into effect? Should they know about it? What is your obligation? Who do you copy on e mails? Who do you suggest that they talk to within the organization?

The good news for the client in a situation like this is that outside lawyers can often be quite helpful in introducing people within HSBC to each other, almost, and to suggest that now is the time to get so-and-so involved, or so-and-so has an expertise or a role that that business unit should be aware of.

The second thing I'd just say about the view from outside on the regulatory front has to do with the role and quality of in house counsel. Over the almost 30 years that I've been working with HSBC, it's extraordinary to go from three lawyers to 950 lawyers, but almost more important is that outside counsel has to understand that the quality and expertise of those in house lawyers have grown immeasurably over the years, and invariably those lawyers are going to know more about their client than you'll ever know. They're going to be much more sensitive to the delicate points that advice often turns on than you will ever be. They need you for a blessing on something that they have worked over very hard in their own right, for months often where you are coming in late, and yet you have a very important additional value that you can bring to the transaction. But I'm just constantly impressed by the level of expertise and quality that you see at an organization like HSBC these days.

A sub-set of that point, in particular, in my area of regulatory advice, is that the relationship between the institution and its regulators has now moved much more in house than it ever was in the old days, and that is a highly developed, highly sophisticated relationship, and needs to be taken advantage of by us as external advisors all the time, as it should be. It's a very personal matter. Individuals have relationships with individual regulators, and whereas before, Milbank might be thought of as the way through to an organization like the Fed for an institution like HSBC, that has long since not been the case, and that's very much for the better. The key people within an organization like this have their relationships, and always you must check with them to make sure that what is going on is being handled properly from their vantage point.

Why don't I stop there and turn it over to Vic, or Jack.

JACK FRIEDMAN: Some decades ago the great global regulatory issue would be things like the gold standard. In the modern world, "Basel" this and just go through it, what are the types of multinational coordinated regulatory regimes, even accounting, maybe

there is some accounting thing, but what are things that are agreed to among countries that is the modern world – I have trouble formulating some questions, because I'm not an expert, and I'm a delayed businessman who reads the Wall Street Journal religiously, and so it's a little bit hard to deal with specialists, you know, renowned experts on a certain subject.

I was wondering if the Speakers could talk about some of the areas where countries coordinate with each other in the financial field.

VICTOR LEWKOW: Do you want to try that, Richard?

WINTHROP BROWN: I was going to say, if you are asking just about the United States, the reaction would be that there is an alarming lack of coordination between regulatory regimes. And it's one of the most fascinating intellectual challenges of a practitioner, and one of the most frustrating things from the point of view of the client, that you have half a dozen federal regulators, 50 state regulators, a whole parallel universe between banking and securities, and none of them ever talks to each other, much less coordinate how their regime should operate in sync.

On the international front, honestly, I don't see a great deal of coordination, although organizations like the Bank for International Settlements, the comparable group for the securities industry, are increasingly trying to bring together a coordinated approach to their industries, and I think that's a very healthy development. I'm not sure on the accounting side whether-

JACK FRIEDMAN: What is "Basel"?

WINTHROP BROWN: Oh, I'm sorry. Basel is a creature of the Bank for International Settlements, which is a group of central bankers from the industrialized world who have gotten together now twice to decide what the right capital rules are for financial institutions, and they adopt a model which is then taken back by the member countries to their own legislatures and regulators, and implemented. And we are now in the process of implementing what is called Basel II, a new set of capital requirements for institutions like HSBC.

VICTOR LEWKOW: Well, I was going to say, it's interesting to see how obviously – regulators in different countries are very aware of the logic in that they ought to be talking to each other. But it doesn't come naturally, especially to make progress. A year or so ago, I had the privilege to represent Euronext in the merger with the New York Stock Exchange. Euronext itself was a combination of stock exchanges and futures exchanges in France, the Netherlands, Belgium, Portugal and the U.K., and the legislators had cobbled together a group that took me aback when I first heard it. It was called the "College of Regulators for Euronext". It was the five national regulators who came together and met and had rotating chairmanships to deal with Euronext when Euronext was formed some years earlier, and now the College of Regulators had to start meeting with the SEC, and just the whole dynamic in trying to cobble together a way to deal with it. It's obviously essential for regulators to work together, but it never works as easily and as smoothly as in a perfect world you would imagine. I think the regulators are trying, but there are lots of impediments to truly having good international regulatory systems in any of the regulated financial service industries.

> "No company today, particularly in the financial services industry, can take risks with reputation, and therefore much time is spent persuading business colleagues to ensure that they involve lawyers as early as possible in all business transactions."
> – *Richard Bennett*

RICHARD BENNETT: My experience is that coordination is definitely an overstated description. On the retail side, we're finding that more and more regulators are talking to each other, and they're sharing their "good ideas". As an example you'll see an approach in the U.K. which is known as "Treating Customers Fairly", which goes much beyond suitability. This is now popping up in Hong Kong, France and Australia as a standard to be met by banks.

The other worrying aspect is that one regulator will look at another and say, "Well, you fined an organization this amount of money; we should be able to fine at the same levels." So fines are increasing almost as a sort of competition between regulators, who are giving the message, "We're tough, so we impose big fines or a big sanction." The regulatory downside of compliance is getting more challenging.

As to the last point, Jack, it is entirely appropriate for you to say that you don't understand Basel II, because the U.S. won't adopt it for another two or three years. We're living with it, but you aren't, yet.

JACK FRIEDMAN: Well, let me go into this a little bit more, because I think the international aspect of your operations and of the industry as a whole is very important. Basically what I come away with from your comments is that if there is some mega-issue, so-called crisis, such as Asia currency or Mexico or this or the credit crunch, it means that everybody has to start going around contacting the agencies, the banks in the different places, and so forth. I assume that the heavy lifting for those sort of global issues and emergencies are in London or in the U.S. – New York or Washington. I assume that those are the places where everybody knows they'd better come in for a meeting and start talking to each other. In other words, those are the U.N.-type locations for the financial community. Is that correct?

RICHARD BENNETT: Yes. My colleagues in the room who work in New York will probably say this is not how it works, but it's how we think it works. It is thought to be one of the biggest lies if you arrive from our group management office and say you're here to help.

JACK FRIEDMAN: You mean from the government agencies?

RICHARD BENNETT: No – from the head office. Your head office helps nobody – it's a view some of my colleagues have. We see our role as a coordinator, and if an issue is multinational, the head office brings it together. In almost all countries, we operate through individually incorporated companies. If there is an issue in the U.S., it would be very much up to the U.S. management's role to sort it out, with help as needed from the head office in London. In the head office we don't have the expertise to advise on everything. If I look at the global legal function, out of the 950 lawyers globally, the legal department in the head office is just nine lawyers, including me, so we have limited capability to be storm troopers to come and sort problems out. Nine times out of ten, we don't have expertise that's better than what is available locally, so we rely on the local legal team but working together and with them giving guidance.

JACK FRIEDMAN: What happens when regulators directly oppose each other; one of them says you can't do something, and the other one says you've got to do it.

RICHARD BENNETT: You have to make a judgment call. We have had issues like that with one of the regulators in this country. We decided that in that case, we would make sure we met all the requirements in order to stay out of trouble in the U.S., because we see it as an important jurisdiction, even if technically we're in breach of regulations elsewhere as

a result. We just had to make a judgment call; that's the legal department doing an assessment of the risks and management making the decision.

JACK FRIEDMAN: Let me give you a non-financial case. This is in the employment area, but it's written large. I was told that American multinationals were upset that in France there was a law passed in the last couple of years that says that in 72 hours you have to tell an employee that they are the subject of an investigation. They were complaining about it because the American tradition is you first investigate, decide if there's anything to tell someone about, and then you say to the person, "We've done enough investigation and now we want to inform you." In France they're being asked to say this to a person before they do the investigation. Not only the regulators, but also the courts can argue with each other about whether you can do something or not, or who has jurisdiction over this or that. How do you handle the direct conflict of the courts including the imperial American courts which feel they have jurisdiction over everything?

RICHARD BENNETT: I'll answer that question very quickly. I don't know a lot about the French case, but our philosophy is that we are a guest in 82 countries in the world, i.e., everywhere apart from the United Kingdom. Therefore, the local law is paramount and the local requirements have to be met. One thing you can't do is say, "This wouldn't work in the U.K.," and therefore ignore it. So in the French case, if the French wanted you to operate in a particular way, you might make representations to the authority that is policing the requirement to try to get them to change it because it doesn't suit, but in the end you have two choices. You either move out of the country if you don't like it, or you comply.

The U.S. courts have given us lots of issues over the many years. One of my abiding memories was with Win when I was in Hong Kong, and the U.S. court subpoenaed the branch of HongkongBank in New York, requiring them to disclose information held in the head office of HongkongBank in Hong Kong. Such an order went straight against Hong Kong legal principles of a duty of secrecy of customer information. There was case law in our favour in Hong Kong but we were being threatened with a fine of a thousand, probably 10,000 U.S. dollars a day for being in breach. Win and his firm put together a very comprehensive memorandum and filed it with the U.S. courts, and they eventually accepted our position. Effectively what the U.S. court was saying was, "You have a presence in New York, and therefore you will tell your head office to give us the information even in breach of local law, because it has nothing to do with us." We got out of jail, thanks to Win's help, but it was tough. If it had gone the other way, I don't know what would have happened. I can think of three situations currently in the U.S. where there are court action which could impact us outside the U.S. The long arm of the U.S. courts is reaching out to try and get not just our assets but customer's assets globally in order to satisfy U.S. judgments, which makes us very uncomfortable, because we may not be able to comply. So how do we deal with that? We will file an amicus brief in the cases; and possibly, we will interplead. We'll try and avoid getting a judgment against us, which would put us in a difficult situation.

JACK FRIEDMAN: This was an actual reported case. I may be distorting it; so I hope you'll recognize what I'm referring to. A global shipping line, which might be the type that would be financed by the bank, went into bankruptcy. They had a "bunker contract"; which was their only relation with the U.S.; they had bought some oil through a New Jersey office. That gave the American bankruptcy court jurisdiction. The company's huge tanker ship was in Singapore. The creditors and sailors filed liens against the ship. The issue was that under American law the sailors got a certain priority, whereas in Singapore under British law, it's a different order.

The judge here in the United States said, "I want you to reorder these things out there in Singapore, because it's an asset of the company that's in front of me." The company's lawyer said, "We can't do that under Singapore law. It's impossible." The U.S. judge said, "Well, I'm very offended by your not cooperating with me, so I, in New Jersey, with this little claim, am going to fine you $100,000 a day." Two weeks later, a million and a half had added up, and the lawyer said, "Ah, we came up with a solution, Your Honor, and this solves the problem." And the judge says, "Well, I'm so happy with your coming up with a solution, so I'll waive the penalty and we'll start fresh."

Now, my question is, how on Earth can you deal with stuff like that?

RICHARD BENNETT: The answer is, you have to rely on extremely good internal and external colleagues to decide on how you'd handle it. Obviously, when you're being fined, you've got to stop that situation somehow. In most cases, and I'm certainly not a U.S. litigation expert, you will find a judge at the end of the day who will be reasonable and accept that actually the jurisdiction of the U.S. court don't go that far. I suppose ultimately, and this is stepping right out of my comfort zone, you will have to take your case up to the Supreme Court and get it argued. We've never had that situation and we've always found that there is a solution somewhere.

JACK FRIEDMAN: You mean the real world is better, is more amiable, than one might-

RICHARD BENNETT: Than a circuit judge somewhere who says, in your example, they have gotten themselves into the jurisdiction of the U.S. court by the Bunker contract and that gives the court the right to hear the case. I wouldn't say we try to avoid U.S. jurisdiction, because we're here in the U.S., but certainly with some of our contracts, we make sure that there is no connection with the U.S. whatsoever, to avoid that long arm. We draft the contract so that no U.S. entity of HSBC is party and make it not subject to U.S. law. We try to make sure that if a dispute came to a court here we could argue, "You don't have any rights to sue us here or to put us into the position of defendant."

It's an unfortunate situation, but that's the world we live in.

JACK FRIEDMAN: With careful drafting, in some situations you can avoid it.

RICHARD BENNETT: You can avoid it.

JACK FRIEDMAN: Victor is the next speaker.

VICTOR LEWKOW: Good morning, everyone. And Richard, thank you, it's always good to see you, and it was very interesting to hear your remarks, some of which reminded me of events that we went through together, including, as Win mentioned, where we were all involved in the Republic and Household acquisitions.

One of the things you mentioned was, I forget exactly how you put it, that you know enough when local lawyers tell you advice that just doesn't sound right, to be able to ask the right questions and to push back and the like. And I think one of the things I most enjoy about representing foreign companies, financial institutions and other foreign companies, in doing acquisitions in the United States, is the opportunity to both learn something, often more than I had expected, about laws in other countries, but also to explain U.S. law in a way that is user friendly to general counsels and business people at the clients so that they can appreciate not only what the U.S. law is, but also what it isn't. Because what you discover, and one of the great pleasures of dealing with Richard and his colleagues, is that they really do have an international view of things. Many of them are not going to know U.S. law, obviously, but they know enough to ask those kind of questions. And by asking those kind of questions, learning, in effect, the next time, what questions you need to be answering for them, even before they ask those questions, and that's a large part of what's necessary in the relationships between international clients and international law firms giving advice in a particular jurisdiction.

I'm going to talk a little bit, at Jack's suggestion, about what's happening right now in the M&A market and some of the financial and legal situations. You know, HSBC, of course, is interested because they are both a company which makes acquisitions from time to time and divests business from time to time and all the variants in between, but also, obviously, because they're a bank, they lend money to other companies who make acquisitions. And so they have a great interest in that, in lending the money, and even more interest in getting paid back.

So I thought I'd say a few words on that subject of acquisition finance. Some of this is well known. We had very super-heated market conditions that drove record levels of M&A activity for 2006, and just about this time last year, it came to an end. What was happening through June 2007 is that most of the deals, and I don't have the statistics, but a large portion of the deals were not strategic acquisitions, were not one company buying another company or merging with another company. Instead, a very large portion of M&A activity was the private equity deals and the heavy leverage that went along with those deals. And during that period private equity deals which kept getting more and more leveraged.

> "Our philosophy is that we are a guest in 82 countries in the world, i.e., everywhere apart from the United Kingdom. Therefore the local law is paramount and the local requirements have to be met."
> – *Richard Bennett*

And there were a lot of factors that were going into the availability of funds. I think you had the large private equity firms which had large amounts of cash from their investors, and they had a very friendly market from the banks and from other sources of debt financing, and competition between the different banks led to both attractive rates, large availability, including large leverage rates, so called covenant-lite loans, in which you had very limited protection to the lenders. My favorite term, "PIK toggle", where you could, going back to a concept with a slightly different name that had been around in the '80's during that overheated M&A activity of what was then known as leveraged buy-outs instead of private equity deals, where instead of paying cash to repay your debt, you could issue more paper. And just defer the payment of the case – so called "Pay In Kind" or "PIK" notes.

So the large private equity fund availability and the willingness of banks to lend on favorable terms combined to make a lot of cash available and led to a large number of deals. At the same time, there was a willingness of companies, senior executives, boards of directors, to sell out, if you could get the right price, and they were often at high prices. A fair number of companies and their CEOs, the combination of the U.S. regulatory environment, Sarbanes-Oxley and stock exchange requirements and the like, plus the activist investors, the hedge funds of the world, could make life quite unpleasant. These various factors created a receptive environment for private equity transactions.

Now, the credit crunch changed all of this. We saw last summer the availability of new funds for deals started to come to an end. And since that point, there have been really no mega-deals. The big deals have come to a complete end. There are private equity firms doing things, they're doing PIPE (Private Investments in Public Equity) investments, and some are looking at doing small private equity acquisitions with limited debt. You're starting to see some private equity activity, but one of the things that everyone is facing both private equity firms and targets in this environment, what will the lenders do? What will the banks do?

And overlaying that has been some of the disputes and litigation on some of the deals that had been signed up before last summer. The Sally Mae deal, the United Rentals deal, the Genesco deal, and the Clear Channel deal are all examples of deals that for one reason or another led to litigation or the threat of litigation and disputes, and what we saw is a couple of things.

One is the paradigm that private equity firms would never walk away from a deal because of reputational issues is clearly dead. I thought of this, Richard, as you were talking about reputational concerns and the HSBC committee, but more generally, besides the committee, the enormous importance of reputation to an organization like HSBC.

But the private equity firms had said for many years that target companies should agree to be acquired by a shell company with basically no money other than $100. They said, "Don't worry", we at private equity firm "X" or private equity firm "Y", even though there is no assurance that the money will be there, would say, "If the money isn't there at closing we'll be out of business". And there were a lot deals done that way in the '80's where well-known private equity firms basically set up a shell company, and the only one who agreed to the acquisition was the shell company, and the target board of directors and shareholders were entirely reliant on reputational consideration.

Over time that changed; targets and their lawyers became more aggressive and insistent on debt commitment letters and equity commitment letters, third-party beneficiary rights and the like; but it was still known, or at least it was known by lawyers who were doing their jobs and by boards who were listening to those lawyers, that in the 2005-2007 period, that to a large extent, private equity firms had options to acquire companies where there was a reverse termination fee, and that was basically the cost of the option. So the only thing protecting targets was that the combination of a reverse break-up fee and the expectation – or hope – that the private equity firm would not be prepared to walk away because of reputational issues. And what we discovered is that, well, reputation by those kind of organizations can be rebuilt. In a crisis, money talks, and people will sometimes worry about reputation next week.

It's very different, it seems to me, for an enterprise like HSBC, which has public shareholders, which has thousands and thousands of employees around the world, which has regulators in every country and the like; it's a different situation; the private equity business doesn't have that regulatory oversight. Also, I

think, any private equity firm knew that other private equity firms were facing the same issues. Therefore other firms would have the reputational issues also. So, unless there were simply going to be no deals, a firm might think that it would turn its back at the negotiating table anyway.

And so people became aggressive, and so did some of the banks. The Clear Channel situation that was just settled a couple weeks ago, of whether or not a 60 or 80 page bank commitment letter had sufficient detail to make it binding. Or whether it was really just a non-binding agreement to agree. That case was settled, at the end of the day, a result that everyone could live with. But the litigation clearly showed that at least some banks were willing to take some reputational damage. And I'm sure they thought long and hard about that, and I'm sure they evaluated with their counsel both the legal risks and the reputational risks. Now they have settled, and it isn't obvious to me that they have suffered terribly much from a reputational standpoint compared with other banks. But time will tell.

So that is affecting the environment we now see. Even in strategic deals, if there is debt that is going to be required by the buyer, we're seeing much more focus by the target board, by its counsel, by its investment bankers, about really understanding how the acquirer is going to finance it; what are the conditions? What are the remedies of the target if the buyer does not perform? Even if the buyer doesn't perform because it can't raise the money and there's no financing condition to the deal? What actual remedy does the target have? And you're seeing a lot more focus on that by target boards.

What we are now seeing in the private equity realm is, again, only much smaller deals, with a lot less leverage and more equity; there hasn't been enough public deals to have a real sense of whether the architecture of the deals of the last few years will continue or will change.

JACK FRIEDMAN: Are there some important decisions by the Delaware courts that are of interest to M&A lawyers?

VICTOR LEWKOW: Well, I certainly hope so! They try to! There's been a number of, over the years, the Delaware courts – it's, who would have thought that the small state of Delaware, without that large a business community, would be the ones who tell much of what we all need to know to do mergers and acquisition transactions, but that is, in fact, as everyone knows, often the case.

There's not been anything that dramatic in the last few months. In fact, I thought it was very interesting that a couple of blocks from here, I saw that what had been the Bear Stearns building already had new name tags, new signs up, as I walked by this morning to come here, and it now says "J.P. Morgan". But it was quite interesting, actually, that in the litigation brought by shareholders attacking how the Bear Stearns board dealt with the entire situation in agreeing to sell originally for $2 and then for $10 per share to J.P. Morgan, that there was litigation brought in both Delaware Chancery Court and New York courts, I think the New York Supreme Court. Historically in recent years, and maybe it turns on which chancellor or vice-chancellor has the case, but it may also turn on the desire or not to make some decisions in some areas. But usually we've seen the Delaware courts fight to take control of those situations. They want the cases involving Delaware corporations of this type. For the most part, they want them decided in Delaware. And it was interesting that Vice-Chancellor Parsons deferred to the New York court and is allowing that litigation to proceed in New York.

JACK FRIEDMAN: Why did he say he was doing that?

VICTOR LEWKOW: The New York case was brought first; and there were a lot of contacts with New York; etc. But it's not clear to me that in other contexts, it would have come out the same way.

There have been a lot of cases, going back to your question, Jack, over the last couple of years, about the duties of a board in selling a company, and that one size does not fit all, in terms of what's the right way for a board to meet its fiduciary duties in selling a company, at least in a cash deal. The board's duty is to obtain the highest price reasonably obtainable. That is the one paramount duty of the board. But there's no one clear way to do that, and there's no one clear thing that's right, in terms of do you run an auction, do you talk to only one prospective buyer? What kind of deal protection can you give the buyer? Is a so called "go shop" necessary? Does it help solve a problem? And if it helps solve a problem for a big company, does it necessarily do the same job for a small company when buyers may not be paying attention. And the Delaware courts keep us busy. They're usually pretty thoughtful, even if we disagree occasionally with what they have to say. But they have good judges down there, and usually the cases are pretty thoughtful and keep us all on our toes.

JACK FRIEDMAN: When a financial institution in the United States wants to make a purchase, such as Bank of America just did with Countrywide, and J.P. Morgan with Bear Stearns, what agencies have jurisdiction? Who do you have to get before you even worry about going to court?

WINTHROP BROWN: You take Bank of America and Countrywide, for example. The average newspaper reader would assume that the Federal Reserve Board had to approve that acquisition. In fact, it's just the piece of Countrywide that is the savings bank that had to be approved. And this is similar in other instances, as well. And it all depends on the status of the acquirer, the nature of the target, how it's regulated and by what regulator; so it's not an easy question to answer in very general terms.

VICTOR LEWKOW: It's the first question the client asks.

WINTHROP BROWN: That's right.

JACK FRIEDMAN: Isn't there the issue that the acquiring bank, holding company, or whatever the entity is, has to end up as a solid operating company?

WINTHROP BROWN: That the parent acquirer does?

JACK FRIEDMAN: Yes. Who looks in and says,

"We think you're going to be stretched too thin and we're not going to come in and bail you out after the fact, so don't do this deal."?

WINTHROP BROWN: Yes, that's very much part of the case made by the acquiring entity, that it will be, that it is strong today and it will be strong after the acquisition, that the target won't sap its resources; it will be a so called source of strength to that target.

VICTOR LEWKOW: That was what brought one deal down. And you'll remind me of the name, but recently there was a private equity deal who was going to take control of a company that had as a subsidiary a bank, and the negotiations with the regulator, who was asserting, even though maybe technically the rules didn't apply, wanted to make sure that there would be a source of strength and wanted the private equity firm to basically guarantee support above what it was putting into the company, and the deal fell apart over that.

WINTHROP BROWN: That's right. I think it was the comptroller that was involved in that.

VICTOR LEWKOW: The comptroller, yes.

JACK FRIEDMAN: In Europe, I know the financial institutions are, in recent years have been buying across borders. What is the similarity and the differences in the regime? I include, for purposes of discussion, the U.K. as part of Europe.

RICHARD BENNETT: The fundamental structure is the same. You've obviously got to negotiate your commercial terms. The regulators apply very similar tests in terms of suitability of acquirer, what you would do for the company, and that comes into their consideration. The thresholds are slightly different. In the U.K., if you want to acquire more than 10% of a U.K. financial institution, you have to get the permission of the Financial Services Authority as the regulator, and then there are various levels above that. There are also substantial competition commission issues, anti-trust issues you'd say in this country, and they may be local or covering all Europe. In the U.K., we have a dual test for competition issues, local and Europe-wide but an applicant doesn't have to apply twice, but must decide whether Europe or U.K. rules apply. I think that the main difference with the U.S. is that you have rather a lot of States. So if you're buying-

VICTOR LEWKOW: Fifty.

RICHARD BENNETT: Fifty.

VICTOR LEWKOW: Plus Washington D.C.

RICHARD BENNETT: Plus Washington. You have 52 potential regulators including Federal if you're buying a nationwide business. We don't have that. We only have one financial regulator if you were doing the same transaction in the U.K. If you're buying a bank in continental Europe with branches or subsidiaries in say ten countries, you'd have ten regulators to apply to. They would be in different countries, and you would have to apply in each one.

> "Just because there is a financial crisis doesn't mean the lawyers don't have a job. Their focus may be different, but they are required to help the business get out of problems more than ever."
> – *Richard Bennett*

We don't have the equivalent of a CFIUS regime in any of continental Europe that I'm aware of; however, that said, some governments would not look kindly on the acquisition of one or two of their major banks.

VICTOR LEWKOW: France, clearly.

RICHARD BENNETT: I wasn't going to mention names, because there are people in the audience who might get embarrassed! But France would be a good example. We bought the fifth biggest bank, and that was about as large as we were ever going to be allowed to buy.

During our acquisition in 1993 of what was Midland Bank in the U.K., the then principal financial regulator – the Bank of England, made it a condition which was non-negotiable that if we wanted to buy Midland, which was one of the clearing banks, the head office of HSBC had to be in England. That did not mean a secretary and a brass plate saying 'Head Office'. It meant the Chairman, the board, and the head office staff being in England. That was the cost of acquiring a major U.K. bank.

You'd get situations like that, and I believe that is what happened with the Dutch with Barclays. They were going to move their headquarters to the Netherlands in order to get approved to buy ABN AMRO. The deal didn't go to Barclays; in the end, it went to Royal Bank of Scotland, and they negotiated some other arrangements.

So there are twists and turns from dealing with regulators so that they are sure the owners have got a presence in their country, and they can't avoid getting onto an airplane when needed because it's inconvenient. If you are going to buy a major bank today, you've probably got to have more nexus with the country of your target bank now than you've ever had before.

JACK FRIEDMAN: A core issue today is the so called credit crunch. What has been the impact on the bank in the last six months or year? What did the bank go through?

RICHARD BENNETT: Us?

JACK FRIEDMAN: You.

RICHARD BENNETT: HSBC?

JACK FRIEDMAN: And maybe the industry generally, but your bank from your standpoint.

RICHARD BENNETT: I'll try and keep this as short as possible! We were the first organization to call problems in the U.S. housing market, because we began to detect through HSBC Finance a deterioration in some of the lending portfolios. This was triggered by rising interest rates and the impact on some of the products that had been sold. We, of the non-U.S. banks, are unusual in the fact that we have a sub-prime lender, i.e., we're directly in the sub-prime market. Citi, Wells and other financial institutions have got similar outfits. So our major hit as HSBC has been in dealing with the loans made by HSBC Finance and, to repeat Victor's comment, we've lent money and we're now worried about getting it back.

We are doing pretty well actually, but this again comes back to an earlier comment: the press is not helpful. It ramps up a story. We've taken quite a lot of write-downs and we're not proud of it, but that's history. We'll work through it. A lot of these loans are for a term period, so I think by the end of 2010 or '11, these loans will have gone through the books. Hopefully, if your economy stays strong, it won't be too painful. If your economy deteriorates, like many organizations, we will have a bigger problem.

In the secondary market, we were relatively small compared with some of the investment banks, so that we were not a big player in acquiring sub-prime debt, repackaging and selling it. That meant we also were not holding a lot of debt instruments ourselves, so we have not had the issues of the size that other financial institutions have had to face.

Somebody gave me a great analogy: we're all in the same storm; we're no different to anybody else; we just happen to be in a somewhat bigger and stronger ship than many other financial institutions. Why are we big-

ger and stronger? Because we have two strengths: our core capital, even now, remains about 9%, when the regulators want banks to maintain a minimum of 6%, so we've got quite a good cushion, and we're still generating our own capital. We haven't had to approach sovereign wealth funds or other investors, and ask them to bail us out and give us new share capital.

The other strength we have is liquidity, which again is a problem that some other banks had. As I said in my presentation, we have locally incorporated banks, and the philosophy of, "You should only lend when you've got a depositor's money to lend." Our liquidity is very strong and it continues to be. At the same time, it throws up other problems – what do you do with surplus liquidity, because you're not always going to be able to guarantee to get it back. On balance however we're in good shape relative to others, because we've got capital and we've got funding.

It's going to be a rocky next 18 months, in my view, and we'll just have to see what happens. We're negotiating, like all banks, a difficult course. But we're not on the rocks.

JACK FRIEDMAN: One more question, and then I'll open this up to the audience. Victor, and anybody else, again, can comment on it. I know that you're saying there's more loan covenants now. But can you give us somewhat more detail of the type of packages or terms that banks are expecting in order to do an M&A deal? It may be interest rates or collateral or covenants or whatever. I don't know the sizes of the deals – are deals in the billions still going on?

VICTOR LEWKOW: Well, I think they're a lot smaller. I think that the banks are just not looking at large numbers. A lot of them are sitting with a lot of acquisition debt on their balance sheets, and whether they've had to take write-downs or not, depend on whether they're held for the long-term or short-term, a sort of strange result where the same loan may have to be written down by one bank but not by another. I mean, there's a very strange concept and side effect of the accounting rules, and so they've written down or have potential write-downs, either way, of large amounts of debt. And there's not much of a market to sell that debt, except at significant discounts. Slowly you're starting to see some of that debt get re sold. Very interesting, the deal announced last week, the Alltel transaction where the private equity firms, which had only bought Alltel, didn't close until late last year, have managed to sell to Verizon Wireless and at a price that appeared to give the two private equity firms a significant profit, between what they got for their equity and what they got for the debt that they held in the company.

So you're starting to see some of the existing debt cleared out, but it is hard to know whether that will continue. There's very little leverage-type lending going on. What's going on is, instead of lending, you know, four or five or six or seven times the amount of equity in the deal, it's like, you know, one times. So the big thing is the banks are lending a lot less, and they have much higher rates of coverage, and they have a lot more equity underneath them in the capital structure.

JACK FRIEDMAN: So they have more cushion?

VICTOR LEWKOW: Correct.

JACK FRIEDMAN: What is the type of interest rate or covenant or security that they're looking for these days?

VICTOR LEWKOW: Rates have obviously moved a great deal. I'm not enough of an expert to comment on the rates. I don't think security packages have changed dramatically. I do think there is somewhat more focus on covenants, definitely, but again, you don't need covenants as much when you have a lot more equity cushion underneath you. So how that is going to develop over the next year or two is not 100% clear.

JACK FRIEDMAN: I'd like to give the audience a chance to ask whatever questions. Are there any questions from the audience? Yes, sir?

AUDIENCE MEMBER: Thank you very much. I'd like to ask a question of Richard Bennett concerning the impact, or what he thinks could be the impact of the current crisis, the turmoil, on banks' legal function in general, on their risk management, for the legal function, and in terms of cost efficiency of legal functions.

RICHARD BENNETT: Thank you. I will split the answer into two. First, what involvement does the legal function have in the present crisis, and I think it's, again, probably two aspects. We do have a continuing role, because there's quite a lot of restructuring going on in various areas. There is the likelihood, of litigation. Personally, I don't think we've seen a huge amount coming against my organization as yet, but it's, to me, a question of time. So that will require the lawyers to do more.

A lot of the other aspects of the credit crunch, go more into the risk function, in looking at continuing the ability to lend, the sectors you're willing to lend, the margins that you will lend at, etc. That doesn't involve much in the way of legal input, because it's really a question of risk and the business deciding what it's going to do with its money. As I said, HSBC is in the happy position that we've got money. If I was at Royal Bank of Scotland, for instance, who just closed the biggest rights issue in the world, 12 billion Sterling, yesterday, the lawyers would have had a huge part to play in the documentation for that transaction.

I think the other aspect looking forward that might happen is, in some companies, businesses will get shut down or substantially reduced, and it is likely, therefore, that the lawyers who support those businesses will have less to do and may have to be let go or assigned to other duties.

So that's the impact on the legal function. On the bigger picture, I think you'll find that legal departments, because they are seen as a pure overhead, will come under pressure to control their costs along with other support functions. With respect to my colleagues on the panel today, when external lawyers ask for a fee rate increase this year, they may not get a great reception. We'll be saying, "Thank you, we're under cost pressure, we'd love you to continue to act for us but we're not going to take a 25% hike in your charge-out rate." So life will get tougher for everyone.

I know of at least one financial institution that has stopped some of its lawyers traveling on business

unless there is a pressing reason. They're cutting back costs. Cost control will apply to the legal function, as well as everywhere else, and this will be one of the impacts of the crunch as financial institutions see their revenues diminishing.

So I foresee two aspects; one is you're just part of a big organization looking at its cost structure, and the lawyers get squeezed like everyone else and the other is the lawyers' involvement in various consequences of the financial situation.

The reality is that in crises, lawyers are probably as valuable as they are in the good times. Just because there is a financial crisis doesn't mean the lawyers don't have a job. Their focus may be different, but they are required to help the business get out of problems more than ever.

JACK FRIEDMAN: Mr. Bennett, what is your relationship or your policy toward outside counsel? How do you select them?

RICHARD BENNETT: We don't have a hard and fast rule. We work on the basis that in almost all countries, we select a panel of what we call "approved firms". That's as much a control feature as ensuring quality of advice, because in many countries, all instructions don't go to external lawyers through the legal department but often go direct from the business. Having a panel ensures that if the business goes to these firms, they know the rates they will be charged, and we know the firm being instructed. That said, obviously there are preferred approved firms who we would turn to for more major acquisitions several of whom are represented here.

This question of selection was asked of my first boss, and he came up with four C's. Let's see if I can remember them. One was Cost-Effectiveness. Obviously we're not going to pay over the top. We want a good service for the right cost. Secondly, it was Commerciality. If an external lawyer wants to write us an academic letter full of case reports, I get quite upset because I could buy and read the textbook, and I don't want to pay for them to write me seven pages of legal theory. Thirdly Competence. We expect a high level of professional legal expertise from our external advisors. The last one, that is most important, is Compatibility. This is the ability to work well with the lawyers and become personal friends. It means that they like working with HSBC; they show interest in what HSBC is doing, not only where there's a gleam of billing dollars in their eyes, and actually want to be a part of our success. These firms will ring us up and say, "Have you picked up this piece of change of law?" and we won't get a bill for it, because they are doing this pro bono.

AUDIENCE MEMBER: Could you please comment on banking in the Islamic world?

RICHARD BENNETT: We launched Islamic banking about six years ago, because it suits our footprint, and at the moment, we have three centers of Islamic finance expertise. It's headquartered out of Dubai in the United Arab Emirates. There's a very strong Islamic finance presence in Saudi Arabia, where we have a 40%-owned bank, and the third area is Malaysia. If you like looking for emerging trends, Indonesia is the obvious one. It's near Malaysia and it's got a huge Muslim population.

In Saudi Arabia to some extent, Dubai, and increasingly in Malaysia, where we've just got a license for an Islamic bank, there is an appetite from the local population for retail products that meet Islamic fundamentals. At its simplest, deals are structured not to have interest, and on the wholesale side, any investment is in Islamically-suitable activities, i.e., you can't invest in gambling, or alcohol-connected activities.

We have a number of bankers in these centers particularly, and they structure suitable products with clients. We have found that it's not just people of the Muslim faith who want these products, and certainly in Malaysia, at least 50% of the non-Muslim customers like the returns on the investments they get from an Islamic product.

As far as the lawyering is concerned, we've debated for some time whether we should have an in-house Islamic finance lawyer. The problem is, where would that person be located and how useful would they be? So we've decided to out-source, for the time being, that area to external law firms. A number of the U.K. law firms particularly have held themselves out as having the expertise.

One of the challenges of recruiting an in house lawyer is that the Sharia interpretation of the law varies, so an interpretation on a particular product from Malaysia would be totally different from the Sharia scholar in Saudi Arabia. The scholars haven't yet unified their approach to be Sharia-compliant globally and so there are variations. Although we can't migrate product between countries, what we've tried to do with an internal practice group is have the principal lawyers in these three jurisdictions – Dubai, Saudi Arabia and Malaysia -talk together to find common principles. We have an Islamic mortgage product in the U.K., for retail customers who want a mortgage, particularly in the Midlands where there's a big Muslim population, and we have an Amanah Finance property fund in this country, which is SEC-registered. It's about four years old, and has been really quite successful.

JACK FRIEDMAN: I wanted to close by asking our Guest of Honor question about the five minutes a month that he has free. What do you like to do with whatever free time you have, either hobbies or travel, or whatever it might be?

RICHARD BENNETT: Difficult as you say, five minutes free just sounds about right! I spend a lot of time sitting at a desk or in an airplane, so on the weekend, I like to get out, and do something physical. We have a property in the country and I find it therapeutic to go out and dig or cut and burn some of the untamed parts of the property. It makes me feel good and gets me away from the little Blackberry screen.

I like sport and watch almost all sports. Particularly on a wet Saturday afternoon, I've no worries about putting the television on and saying, "Right, I'm going to watch this game," or whatever, I've recorded. By the end of the day, a nice bottle of wine always goes down very well!

JACK FRIEDMAN: Thank you very much, and thank you to his family.

I wanted to thank everyone here. The audience members are our special guests for the Directors Roundtable, and we want to thank you for coming. Richard, we have a greater sense of your responsibilities and achievements of your firm, and I want to thank the Distinguished Speakers. We can't afford your collective billing rates, so I want to thank you for the donation of your time and expertise. If the audience would like to come up and say hello to the speakers one to one, please feel free.

Thank you. ■

Victor Lewkow

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CLEARY GOTTLIEB

Victor I. Lewkow is a partner based in the New York office.

Mr. Lewkow's practice focuses on public and private merger and acquisition transactions. He also advises corporations and their boards regarding governance issues and the fiduciary duties of directors.

The American Lawyer has named Mr. Lewkow as a "Dealmaker of the Year." Mr. Lewkow is consistently listed as one of the leading merger and acquisition lawyers by Chambers Global Guide to the World's Leading Lawyers and Chambers USA – America's Leading Lawyers for Business, which quotes clients as stating that he "gets right to the heart of a deal," "is 'terrific' to work with" and is "a balanced adviser with great judgment." Mr. Lewkow is similarly listed as a leading merger and acquisition lawyer by numerous other publications including The International Who's Who of Business Lawyers, PLC Which Lawyer? Yearbook, and Euromoney's Guide to the World's Leading Mergers and Acquisitions Lawyers. Mr. Lewkow has also been recognized as a leading corporate governance lawyer by The International Who's Who of Business Lawyers, PLC Which Lawyer? Yearbook and Euromoney's Guide to the World's Leading Corporate Governance Lawyers.

Mr. Lewkow is Co-Chair of Tulane's Corporate Law Institute, the leading annual seminar for U.S. merger and acquisition lawyers, and is a regular speaker at the Practicing Law Institute's annual Contests for Corporate Control seminar. Mr. Lewkow is widely published on merger and acquisition, fiduciary duty and corporate governance topics and he is a member of the Editorial Advisory Board of The M&A Lawyer. He is the author of the Corporate and Securities Law chapter in the Manual of Foreign Investment in the United States, Third Ed. 2004. Mr. Lewkow has taught mergers and acquisitions as an Adjunct Professor at New York University School of Law and has also been a guest lecturer at Harvard, Yale and the University of Pennsylvania law schools.

Mr. Lewkow joined the firm in 1973 and became a partner in 1982. He received a J.D. degree, magna cum laude, in 1973 from the University of Pennsylvania Law School, where he was Comment Editor of the Law Review. Mr. Lewkow received an undergraduate degree from SUNY Binghamton.

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Winthrop Brown is a partner in the Firm's Washington, DC office and a member of Milbank's Global Finance practice group. He concentrates on U.S. regulatory issues affecting foreign and U.S. commercial banks, bank holding companies, broker-dealers, investment advisers and their affiliates. Mr. Brown has over 25 years of experience in advising leading banking organizations on a wide range of matters involving complex structured finance transactions, novel financial products and services, bank acquisitions, bank and broker-dealer formations and changes in control, and ongoing compliance with U.S. banking and securities laws and regulations.

Mr. Brown frequently lectures and participates in panel discussions and seminars on these issues. He also has been active in, and served on the boards of, various local nonprofit organizations. He is a member of the District of Columbia Bar. Before joining Milbank, Mr. Brown was partner and chair of the financial institutions practice group at Shaw Pittman, resident in its Washington, DC office.

Mr. Brown received his Juris Doctorate from the George Washington University School of Law in 1974 where he was a member of the Order of the Coif. He also received a Masters of Science degree in International Relations from the London School of Economics and Political Science in 1971 and a Bachelor of Arts degree from Stanford University in 1970.

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