paBanker
The Official Magazine of the Pennsylvania Bankers Association

Navigating the Liability Minefield: Guidance for Officers and Directors of Troubled Banks

ABOUT THE AUTHORS:

Patrick Egan is co-chair and *Eric Reed* is a member of the white collar compliance and defense practice group in the Philadelphia office of Fox Rothschild LLP.

With bank failures and FDIC enforcement and civil actions at all-time highs, directors and officers of FDIC-insured banks must be more vigilant than ever to avoid potential exposure to regulatory and civil action by the FDIC.

The FDIC may commence a regulatory action to remove an individual from any FDIC-insured institution and assess civil monetary penalties. To prevail, it must prove that the institution-affiliated party: (1) violated a law or regulation, participated in an "unsafe or unsound banking practice," or breached a fiduciary duty; (2) caused loss to the bank or gain to the individual by reason of such action or omission; and (3) the action or omission demonstrates personal dishonesty or demonstrates willful or continuing disregard for the safety and soundness of the bank.

The FDIC may also commence a civil action seeking monetary damages. In this type of action, liability generally exists for gross negligence that caused losses to the bank. The FDIC as receiver may also claw back compensation from senior executives and directors whose actions or omissions "materially contributed" to the bank's failure.

To prepare for the possibility of regulatory and/or civil action, officers and directors of troubled banks should:

1. Confirm that the bank's loan manual and policies and procedures require adherence to best practices for loan underwriting and administration.

2. Confirm that the bank follows the manual and policies.

3. Document remedial actions. Meeting minutes should reflect objections to and scrutiny of loan applications and other bank actions. Confirm that such documentation is stored in a manner that will be preserved if and when the FDIC assumes control of the bank.

4. Consider engaging personal counsel separate from the bank's existing counsel. Once the FDIC takes over the bank as receiver, the bank's counsel becomes the FDIC's counsel.

5. Review your D&O coverage, paying particular attention to: coverage for defense costs, regulatory exclusions, and "insured against insured" exclusions whereby the carrier may deny coverage for claims brought by the FDIC. If the existing coverage is lacking, consider obtaining better coverage while you are still in a position to do so.

Following these recommendations and documenting good faith efforts to address issues could help avoid both regulatory and civil liability if a bank fails.