SHOULD BOARD MEMBERS GET THEIR HEADS EXAMINED?

Jeff Gerrish has sued directors, protected directors, and been a director. Who better to answer this timely question?

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Why in the world would anyone in their right mind agree to serve on the board of directors of a community bank?

For directors and trustees at most community banks and savings institutions, it is certainly not about the pay. Nor can board members take advantage of the bank's credit facilities, except in compliance with some pretty strict regulations like Reg O.

So, again, why would anybody do it?

Most of the directors I have run across in community banks over the last 30 years have joined the ranks of the board because they continued to believe it is an honor that allows them to economically develop the community and do something positive, notwithstanding the potential liability.

I, too, in my past life, for approximately five years was on a board of directors of a larger holding company's subsidiary bank. In view of my checkered past-having sued bank directors for FDIC in the late 1970s-when the bank announced publicly that I had joined its board, I quickly received a number of inquires from my consultant and attorney friends around the country inquiring about my apparent lobotomy and other mental health issues.

My response then, as it would be now, is that the risk of service on a community bank board is still manageable.

What is the real risk, anyway?

The risk generally originates from three sources: shareholders, regulators, and FDIC as Receiver of the bank if it fails.

One risk is that some stakeholder at some point is going to allege that the director did not do his or her job, and sue the board for negligence (or worse-fraud-if the bank or its holding company is a public company). As long as the bank is open and it is simply a shareholder derivative suit, then the board member's directors and officers insurance policy should cover liability.

As a board member of an open bank (as opposed to a failed one), board members also have risk from your friendly federal regulators who, under a number of circumstances, e.g., failure to comply with a Consent or Cease and Desist Order, can levy civil money penalties against both board members and the bank. The directors and officers insurance policy provides less protection in this situation, unless the directors have paid their own premium for civil money penalty coverage. Even if the directors have not paid their own portion of the premium for the civil money penalty coverage, the directors and officers insurance policy generally covers litigation costs for the most part in a civil money penalty action.

(For you technocrats, the interplay of FDIC Regulation Part 359 and the directors and officers insurance policy is fairly dicey. Send me an email and I will explain it to you.)

If you happen to be on the board of a community bank that fails, however, then your risk as a director is much more pronounced. For the most part, most directors and officers insurance policies are drafted to exclude claims by the Receiver of a bank (FDIC) after a bank fails. (For that matter, they usually exclude claims by any federal agency.)

Although 220-plus banks have failed in the last two years, that is still a small portion of the population of about 8,000 institutions. To date, no directors and officers claims have been filed by FDIC in connection with failed banks. However, a number of "nasty-grams" to directors who FDIC as Receiver believes may have directors and officers insurance coverage, have been distributed. Once that occurs, the filing of lawsuits by the FDIC as Receiver of a failed bank, or in its corporate capacity as the assignee of the claim, is only a matter of time.

Still, your chance of being in the situation as a director of a failed bank is, in all likelihood, remote.

So, circling back...

Is serving as a director of a community bank all red carpets and rose petals? Absolutely not.

Is the risk manageable? Probably so.

Would I do it again?

Probably so.