A PARTY NO ONE WANTS AN INVITATION TO

If your bank failed or is on its way, deep pockets or D&O coverage mark your board for a lawsuit

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Recently, an FDIC spokesman indicated that FDIC's Board had authorized suits against approximately 50 officers and directors of failed banks-no information on how many banks this involved, but it appears "the party is getting started." As part of my checkered past, having been the FDIC's head of what was at that time the Directors' Liability Section (now the Professional Liability Group), I understand why they go after directors.

Assessing the potential risk of suit

Two issues are present that should be raised early on, if you are worried:

1. Did the directors do something wrong, which could be negligence, gross negligence, recklessness, and the like?

2. Do they have any money that the FDIC can recover?

I was with a group of directors of a failed bank a few months back who wanted "an hour" of my time to assess the likelihood of being sued.

It took about five minutes.

I asked the board members my two questions:

Did you do anything wrong? Answer: Probably.

Do you have any money? Answer: No, we are all broke.

My response: Then the likelihood of being sued by FDIC is zero.

Understanding FDIC's motivation

FDIC, in its receivership capacity, is interested only in collecting money-not in punishment.

Because of that, if your bank fails and you have a directors' and officers' insurance policy that survives the failure, your likelihood of getting sued is as close to 100% as it can be. Nothing has changed in that regard from when I was there. If there is a big pot of money, a case will be constructed.

Makings of a case

So what do most of these directors' liability suits involve?

First of all, if insurance is involved, FDIC quickly gets a "nasty-gram" out to the directors reciting all of the allegations. These chiefly come from the last bad exam before the bank failed. The directors are advised to notify their insurance carrier.

FDIC also sends the letter directly to the insurance carrier to make sure, as much as they can, that insurance coverage is locked in.

The actual allegations in a directors' liability case will primarily involve losses on loans that "never should have been made" had the board been doing its job.

But wait, says the board member, can't we rely on management?

Yes, reliance on management is a defense-as long as that reliance is "reasonable."

It is not reasonable to rely on your management after management has been severely criticized at prior exams and the board does not do anything to make sure management has addressed the criticism and reported back to the board.

First steps on a bad trip

As noted, the "party is just getting started."

If the current situation is consistent with historical situations, then at least half or so of the boards in connection with failed banks will be sued by FDIC, attempting to collect money for the receivership estate (of which it is the largest creditor).

It's a miserable time for these directors, since the process is not the least bit speedy. If insurance is involved, the carrier's goal is to hang onto its money, and do not forget that lawyers and expert witnesses are involved also. This never seems to accelerate the process.

Once the bank fails, the "sword" will be hanging over the director's head, in the normal course, for five years or so.

In any event, in directors' liability litigation, FDIC is just like any other plaintiff:

If it can recover, it is worth spending hundreds of thousands of dollars in legal fees for private counsel to bring the lawsuit.

If it cannot recover, it is not going to waste its time and resources.

We have seen an uptick in requests by the regulators for financial statements of directors in connection with the examination of troubled or likely failing institutions.

Some directors just flat out refuse to give them (which is my general advice); others are on file in the bank as a matter of course. Any documents in the bank, the FDIC, in its examination capacity, can review.

In any event, it is clear "the party is getting started."

Just hope you don't receive an invitation.

About the Author

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