

# LEGAL ISSUES AFFECTING DIRECTORS AND OFFICERS OF FAILED BANKS

Directors and officers of financial institutions that are failing or that have failed must confront a range of legal issues throughout the resolution process. Despite the best efforts of directors and officers to comply with applicable laws, regulations, and fiduciary duties, government agencies and private plaintiffs frequently bring suit against the former directors and officers of failed banks and thrifts or their holding companies seeking sanctions ranging from civil money penalties to prohibition orders to restitution and damages.

Directors and officers of failed banks should be aware of the following issues that may arise and know that Covington has experience helping clients navigate these difficult situations.

- **FDIC Claims:** Bank and thrift failures typically cost the deposit insurance fund of the Federal Deposit Insurance Corporation millions and, in some cases, billions of dollars. The FDIC often brings suit against the former directors and officers of failed institutions to recover a portion of these costs to the insurance fund.
- **Regulatory Enforcement Actions:** The institution's primary regulator also may pursue enforcement actions against the failed bank's officers and directors, seeking to impose civil money penalties or orders prohibiting future participation in the bank or thrift industry. However, the primary regulator often defers to the FDIC before deciding to take action.
- **SEC Investigations:** If the failed institution's holding company is a public company, the SEC often will investigate whether the company's public disclosures contained fraudulent misstatements or omissions in violation of the relevant securities laws. If the SEC believes there is a securities law violation, it is not unusual for the SEC to assert a claim against the former officers and directors for the alleged fraudulent misstatements.
- **Securities Class Actions:** If the failed bank or thrift was owned by a public company, shareholders may file securities class action suits, alleging fraudulent misstatements in the company's securities filings and seeking damages from the company's former directors and officers.
- **ERISA Class Actions:** Private plaintiffs who were participants in the company's retirement plans often will bring class action lawsuits under ERISA, alleging that administrators of the company's retirement plans (who are often officers or directors of the company), breached their fiduciary duties in making investment decisions involving the company's stock and/or permitting excessive expenses.
- **Criminal Investigations:** Depending on the facts involved in a specific bank failure, the Department of Justice or local U.S. attorney's office may open a criminal investigation to determine whether the actions of individual directors and officers warrant criminal prosecution.
- **Bankruptcy Claims:** When a bank or thrift fails, the institution's parent company frequently declares bankruptcy. In these situations, the trustee appointed for the debtor company often seeks to recover damages from the former officers and directors, claiming that their actions breached their fiduciary duties of care and/or loyalty to the company and, in some cases, even allegedly caused the company to declare bankruptcy.

- **D&O Insurance Issues:** Even though most financial institutions and their holding companies have directors and officers liability insurance, insurance carriers providing this coverage may seek to limit the amount of coverage available. For example, depending on the specific insurance policies and the facts of a specific case, carriers may contend either that coverage is not available at all or that all the covered activities relate back to actions occurring in a single policy year.

## HOW COVINGTON CAN HELP

Covington is exceptionally well qualified to assist financial institution directors and officers who find themselves confronting litigation and/or government investigations resulting from the current financial crisis. We have extensive experience with all the issues listed above. Our involvement in these issues dates back to our representation of clients in the savings and loan crisis of the 1980s and is as current as our ongoing representation of the CEO of the former IndyMac Bank. Many of our lawyers also have served in high-ranking government positions, and we are thoroughly familiar with the unique challenges of handling simultaneous government investigations and private litigation. We have regularly been able to lead clients through the many potential areas of exposure that arise when a bank or thrift institution fails.

For more information about how we can assist, please contact one of the following attorneys:

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