

# LEGAL ISSUES AFFECTING DIRECTORS AND OFFICERS OF TROUBLED BANKS

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

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

- **Regulatory Enforcement Actions:** The institution's primary regulator may pursue enforcement actions against the troubled bank's officers and directors, seeking to impose civil money penalties or orders prohibiting future participation in the bank or thrift industry.
- **SEC Investigations:** If the troubled 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 officers and directors for the alleged fraudulent misstatements.
- **Securities Class Actions:** If the troubled bank or thrift is 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 directors and officers.
- **ERISA Class Actions:** Private plaintiffs who are 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.

Of course, if the troubled institution's financial condition does not improve and instead results in failure, the risk of government enforcement actions and civil litigation increases. The now former directors and officers also are likely to face additional areas of exposure, including the following:

- **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.
- **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 faces serious financial difficulties, including those that are able to stage a financial recovery and those that unfortunately result in failure.

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

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