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LEGAL LIABILITY

What Directors and Officers at Failed Banks Should Know

The law firm Covington & Burling's involvement in defending financial institutions and their directors and officers dates back to the representation of clients in the savings and loan crisis of the 1980s and is as current as the ongoing representation of the CEO of the former IndyMac Bank. Some of the lawyers have served in high-ranking government positions, such as former Comptroller of the Currency John Dugan. *Bank Director* magazine talked to Covington & Burling partner Jean Veta recently about what steps officers and directors should take if they are sued and what trends she sees in liability cases.

What are some of the first steps officers and directors should take if their bank fails?

As soon as the bank fails, they should get legal counsel—in fact, they should get counsel when they see the bank is headed toward receivership. The bank's counsel cannot represent the individuals because the bank counsel's client is the bank, not the individuals. Counsel for the individual officers and directors can assess the probability of getting sued and assist these individuals in preparing for potential lawsuits. In addition, counsel can help the individuals determine whether they have directors and officers (D&O) liability insurance and, if so, how to seek coverage under those policies.

What kinds of claims does the FDIC make in its lawsuits against officers and directors?

The FDIC brings suits against officers and directors for damages caused by the loss to the deposit insurance fund when the FDIC put the bank into receivership. Although each case is different, the FDIC typically will allege that the officers and directors were negligent or breached their fiduciary duty with respect to some activity that purportedly resulted in the bank's failure. These claims often focus on such areas as the underwriting for residential mortgage loans, commercial real estate lending practices or insider transactions.

What other kinds of legal exposure do officers and directors face?

In addition to suits by the FDIC, the officers and directors can face other types of lawsuits, including those filed by private plaintiffs, a holding company's bankruptcy trustee or the bank's primary regulator. If the bank was publicly held, the individuals may

also risk lawsuits by shareholders and the Securities and Exchange Commission. In the worst cases, the Department of Justice or local U.S. attorney's office may open a criminal investigation.

Because the officers and directors can face a number of different lawsuits, it is important to develop a legal strategy that deals with all the potential areas of exposure. You need to make sure, for example, that the individuals' defense theory in an FDIC case doesn't adversely affect the individuals' defense against claims being asserted by the holding company's bankruptcy trustee or the bank's primary regulator.

You made reference to the bank's primary regulator. What role do they play?

It is now becoming apparent that in addition to the traditional suits by the FDIC, the bank's primary regulator may also seek to go after individual officers and directors if the regulator believes the individual's conduct was especially problematic. In those circumstances, the bank's primary regulator typically will seek civil money penalties and/or prohibition orders that would bar the individual from participating in the banking industry.

What should an officer or director know about D&O insurance?

The availability and amount of D&O insurance is often important in determining whether the individuals have adequate resources available to mount a defense against the various threatened claims. Although most financial institutions have D&O insurance, the insurance carriers may seek to limit the amount of coverage available, so the individuals need to know how to respond to the carrier's position. D&O insurance also is an important factor in the FDIC's decision to sue the officers and directors. Unless the individuals were really bad actors, the FDIC typically is not interested in suing an individual with modest personal assets and little or no D&O coverage. In contrast, the primary bank regulator may well go after an officer and director—regardless of the level of personal assets or D&O insurance—if the regulator believes the individual's conduct was especially bad. In these circumstances, the primary regulator is not looking for substantial monetary damages (as is the case in an FDIC lawsuit), but rather a prohibition order or civil money penalty that comes out of the individual's own pocket.



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