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Minimizing Bank Officer and Director Liability in an Era of Heightened Regulatory Scrutiny

Theories of Liability and Defenses, Lessons from FDIC Litigation,
CFPB/State AG Scrutiny, Indemnification and D&O Coverage

TUESDAY, JANUARY 12, 2016

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Mary C. Gill, Partner, **Alston & Bird**, Atlanta

John E. (Sean) Johnson, Partner, **Johnson & Cassidy**, Tampa, Fla.

Dennis S. Klein, Partner, **Hughes Hubbard**, Miami

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FDIC Litigation by the Numbers

- **465** Number of banks closed by regulators between 2008 and 2012
- **150** Number of suits the FDIC has authorized against former bank D&Os in connection with failed institutions
- **108** Number of lawsuits actually filed by FDIC against former bank D&Os
- **1,207** Number of individual D&Os against whom FDIC sought to impose personal liability in connection with alleged losses to a failed bank
- **826** Number of former bank D&Os sued by FDIC
- **86** Number of FDIC / D&O settlements
- **1** Number of jury trials of FDIC v. D&Os

Director Protection Statutes

- A company's articles of incorporation may include exculpation clauses, as permitted by state law, to eliminate or limit the monetary liability of a director to the corporation or its stockholders for acts, or failures to act, as a director, with certain exceptions.

- Exculpation clauses can insulate directors from personal exposure for a breach of the duty of care, but not for a breach of loyalty, failure to act in good faith, or an intentional or knowing violation of law on the part of the director.

Director Protection Statutes

State statutes may differ in important respects:

- **Georgia**: "Notwithstanding the foregoing, a bank or trust company may provide through an amendment to its articles of incorporation for the elimination or limitation of the personal liability of a director to the shareholders of the bank or trust company to the same extent as a business corporation . . . ." O.C.G.A. § 7-1-493(e) (emphasis added).

- **North Carolina**: The articles of incorporation may set forth "a provision limiting or eliminating the personal liability of any director arising out of an action whether by or in the right of the corporation or otherwise for monetary damages for breach of any duty as a director," subject to certain limitations. N.C. Gen. Stat. § 55-2-02(b)(3) (emphasis added).

Director Protection Statutes

What difference does this make?

- "Georgia law permits a bank, in its articles of incorporation, to eliminate or limit the personal liability of its directors to the shareholders of the bank" not to the bank itself. *FDIC v. Skow*, 2012 U.S. Dist. LEXIS 153604, at *9 (N.D. Ga. Feb. 27, 2012).

- "North Carolina law allows corporations to protect directors from liability for ordinary negligence by including exculpatory clauses in their articles of incorporation . . . . [A] corporation may limit personal liability for a director's breach of a duty of care, so long as the director did not know or believe his or her actions to have been clearly contrary to the corporation's best interest." *FDIC v. Rippy*, 799 F.3d 301, 311 (4th Cir. 2015) (emphasis added).

Indemnification and Advancement of Expenses

- Bank bylaws may provide for mandatory indemnification an advancement for actual or threatened claims, provided that:
  - officer/director must have conducted himself/herself in good faith; and
  - officer/director must have reasonably believed his/her conduct was in or not opposed to the best interests of the corporation.

- Federal regulations, state statutes and bylaws determine the applicable standards, procedures, and limitations.

- Prohibited indemnification payments include payments or reimbursements for any civil money penalty or judgment resulting from any administrative or civil action instituted by any federal banking agency. 12 C.F.R. § 359.1.

Separate Indemnification Agreements

- Individual indemnification agreements should provide that the bank will indemnify the individual to the fullest extent permitted by law in connection with any proceeding arising out of the individual's service as a director or executive officer, including the advancement of legal fees.

- Advantages include:
  - Broader protection through well-defined terms (*e.g.*, "expenses," "proceeding," etc.)
  - May include fees-on-fees

D&O Lines of Defense

- Exculpation, indemnification, advancement
- D&O insurance
- Document good faith informed decision making process

Minimizing Bank Officer and Director Liability in an Era of Heightened Regulatory Scrutiny

Dennis S. Klein
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201 South Biscayne Boulevard, Suite 2500
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Risk Mitigation Measures
D&O Insurance

- Verify that bank provides D&O insurance for directors and officers
  - Ask for a copy, know its terms
  - Be vigilant on renewing the policy
- Consider excess coverage
  - Excess coverage typically has same terms as primary policy
  - May have additional exclusions

Risk Mitigation Measures
D&O Insurance

- Know what exclusions apply to your policy
  - Insured versus insured exclusion – typically precludes coverage for claims brought by any insured (e.g., the FDIC in its capacity as receiver for the bank) against any other insured (e.g., the bank's D&Os). Majority of courts have held this exclusion would not preclude coverage in an FDIC initiated suit.
  - Regulatory exclusion – typically precludes coverage for claims brought by any government agency. May prevent coverage for FDIC initiated suits.

Risk Mitigation Measures
D&O Insurance

- What to do if you think you have a claim
  - Send a demand letter as soon as possible. Do not wait for a formal complaint to be filed.
  - Consider retaining independent counsel
    - Most D&O policies are "wasting," meaning defense costs paid out of policy limits. Independent counsel can help protect against unnecessary wasting of the policy.
    - Independent counsel can fully represent the interests of the D&Os and apply pressure when necessary to the insurer to settle.

FDIC v. D&O Litigation: Lessons Learned

Reexamining the Standard of Care

- Officers and Directors of Florida corporations are protected by the Business Judgment Rule.
- Officers and Directors are only held personally responsible upon showing that they engaged in conduct that was either fraudulent, illegal, or in bad faith.
- *FDIC v. Stahl*, 89 F.3d 1510 (11th Cir. 1996).

Reexamining the Standard of Care

F.D.I.C. v. Stahl, 89 F.3d 1510 (1996)

KeyCite Yellow Flag - Negative Treatment
Declined to Extend by F.D.I.C. v. Adams, N.D.Ga., April 10, 2013

89 F.3d 1510
United States Court of Appeals,
Eleventh Circuit.

FEDERAL DEPOSIT INSURANCE CORPORATION,
as manager of the Federal Savings and
Loan Insurance Corporation Resolution
Fund, Plaintiff–Appellant, Cross–Appellee,
v.
Angelique O. STAHL, Ralph F. Cheplak,
Defendants–Appellees, Cross–Appellants,
Ross P. Beckerman, W. George
Allen, Defendants–Appellees,
Ira C. Hatch, Jr., Allen E. Baer,
Ronald M. Bergeron, Sr., Defendants.

No. 94–4684. | Aug. 2, 1996.

Federal Deposit Insurance Corporation (FDIC) brought action against former officers and directors of savings and loan, alleging negligence in relation to certain loans approved by directors. The United States District Court for the Southern District of Florida, No. 91–7122– CIV, Wilkie D. Ferguson, Jr., J., 840 F.Supp. 124, 854 F.Supp. 1565, rejected jury verdict in favor of FDIC and entered a "take-nothing" judgment in favor of directors. FDIC appealed, and two of former directors cross-appealed. The Court of Appeals, Black, Circuit Judge, held that: (1) federal statute providing that director or officer of insured depository institution may be held personally liable for gross negligence does not preempt state laws with lesser liability standards; (2) FDIC's action was governed by negligence standard as provided by statute; (3) whether former directors of savings and loan exercised due care with respect to several bad loans approved by directors was for jury; and (4) FDIC's negligence action was not barred by Florida's four-year statute of limitations for negligence claims.

Affirmed in part; reversed in part; and remanded.

Hatchett, Circuit Judge, concurred in part and dissented in part and filed an opinion.

West Headnotes (12)

[1] **Federal Civil Procedure**
Evidence
Judgment notwithstanding the verdict (JNOV) should only be entered if, in viewing all evidence and construing all inferences in light most favorable to nonmoving party, court finds no reasonable juror could have reached verdict returned.

3 Cases that cite this headnote

[2] **Federal Courts**
New Trial, Rehearing, or Reconsideration
Ruling on motion for new trial is generally reviewable for abuse of discretion; when new trial is granted, however, Court of Appeals employs more stringent application of same standard.

3 Cases that cite this headnote

[3] **Banks and Banking**
Statutory provisions
Building and Loan Associations
Liability of officers
States
Banking and financial or credit transactions
Federal statute providing that director or officer of insured depository institution may be held personally liable for gross negligence does not preempt state laws with lesser liability standards and, thus, former directors of savings and loan could be held liable for negligence under Florida law in action by Federal Deposit Insurance Corporation (FDIC) alleging negligence in relation to certain loans approved by directors; saving language at end of provision permits claims under "other applicable law," i.e., state law for simple negligence. Federal Deposit Insurance Act, § 2[11](k), as amended, 12 U.S.C.A. § 1821(k).

5 Cases that cite this headnote

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Consistent with the above, we hold the application of the BJR in Florida does not require that the FDIC establish gross negligence to sustain its burden in this case. While some courts such as *Mintz* have held the BJR elevates the simple negligence standard under Fla.Stat. § 607.111(4) to one of gross negligence, *Mintz,* 816 F.Supp. at 1546; *see also In re Southeast Banking Corp.,* 827 F.Supp. 742, 747 (S.D.Fla.1993) (holding that pre–1987 Florida law establishes a gross negligence ***1518** standard), *rev'd on other grounds,* 69 F.3d 1539 (11th Cir.1995), we disagree.[14] *See FDIC v. Gonzalez–Gorrondona,* 833 F.Supp. 1545, 1556 (S.D.Fla.1993) ("[P]rior to July 1, 1987, the law of Florida imposed liability on corporate directors and officers for simple negligence"); *FDIC v. Haddad,* 778 F.Supp. 1559, 1567 (S.D.Fla.1991) ("Defendants' position that in general there is no cause of action against corporate directors under Florida law for 'simple negligence' is unfounded.")

The court-made BJR does not change Florida's pre–1987 statutory simple negligence standard to a gross negligence standard; it merely protects directors who exercised reasonable diligence in the first instance from

liability on the merits of their business judgment, unless they acted fraudulently, illegally, oppressively, or in bad faith. Thus, based upon our above conclusion that § 1821(k) does not preempt state law establishing a lesser standard of fault than gross negligence, we hold the district court properly determined that the standard of care governing the actions of the directors in this case was ordinary negligence. Only if the directors met this standard were they entitled to the protection of the BJR.

John E. Johnson JC Johnson & Cassidy

Reexamining the Standard of Care

- Florida's Statutory Business Judgment Rule, *Section 607.0831, Florida Statutes*

607.0831. Liability of directors, FL ST § 607.0831

West's Florida Statutes Annotated
Title XXXVI. Business Organizations (Chapters 605-623)
Chapter 607. Florida Business Corporation Act (Refs & Annos)
Part I. General Provisions

West's F.S.A. § 607.0831

607.0831. Liability of directors

Currentness

(1) A director is not personally liable for monetary damages to the corporation or any other person for any statement, vote, decision, or failure to act, regarding corporate management or policy, by a director, unless:

(a) The director breached or failed to perform his or her duties as a director; and

(b) The director's breach of, or failure to perform, those duties constitutes:

1. A violation of the criminal law, unless the director had reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe his or her conduct was unlawful. A judgment or other final adjudication against a director in any criminal proceeding for a violation of the criminal law estops that director from contesting the fact that his or her breach, or failure to perform, constitutes a violation of the criminal law; but does not estop the director from establishing that he or she had reasonable cause to believe that his or her conduct was lawful or had no reasonable cause to believe that his or her conduct was unlawful;

2. A transaction from which the director derived an improper personal benefit, either directly or indirectly;

3. A circumstance under which the liability provisions of s. 607.0834 are applicable;

4. In a proceeding by or in the right of the corporation to procure a judgment in its favor or by or in the right of a shareholder, conscious disregard for the best interest of the corporation, or willful misconduct; or

5. In a proceeding by or in the right of someone other than the corporation or a shareholder, recklessness or an act or omission which was committed in bad faith or with malicious purpose or in a manner exhibiting wanton and willful disregard of human rights, safety, or property.

(2) For the purposes of this section, the term "recklessness" means the action, or omission to act, in conscious disregard of a risk:

(a) Known, or so obvious that it should have been known, to the director; and

(1) A director is not personally liable for monetary damages to the corporation or any other person for any statement, vote, decision, or failure to act, regarding corporate management or policy, by a director, unless:

(b) The director's breach of, or failure to perform, those duties constitutes:

1. A violation of the criminal law, unless the director had reasonable cause to believe his or her conduct was lawful or had no reasonable cause to believe his or her conduct was unlawful. A judgment or other final adjudication against a director in any criminal proceeding for a violation of the criminal law estops that director from contesting the fact that his or her breach, or failure to perform, constitutes a violation of the criminal law; but does not estop the director from establishing that he or she had reasonable cause to believe that his or her conduct was lawful or had no reasonable cause to believe that his or her conduct was unlawful;

2. A transaction from which the director derived an improper personal benefit, either directly or indirectly;

3. A circumstance under which the liability provisions of s. 607.0834 are applicable;

John E. Johnson

JC Johnson & Cassidy

Reexamining the Standard of Care

- Disparity of exposure between officers and directors is not unique to Florida.

- The Fourth Circuit Court of Appeals has ruled that protection provided to directors under North Carolina's business judgment rule insulated them from negligence liability.

- *FDIC v. Rippy*, 799 F.3d 201.

Reexamining the Standard of Care

F.D.I.C. ex rel. Co-op. Bank v. Rippy, 799 F.3d 301 (2015)
2015 WL 4910473

799 F.3d 301
United States Court of Appeals,
Fourth Circuit.

FEDERAL DEPOSIT INSURANCE CORPORATION, as Receiver for COOPERATIVE BANK, Plaintiff–Appellant,
v.
Richard Allen RIPPY; James D. Hundley; Frances Peter Fensel, Jr.; Horace Thompson King, III; Fredrick Willetts, III; Dickson B. Bridger; Paul G. Burton; Ottis Richard Wright, Jr.; Otto C. Buddy Burrell, Jr., Defendants–Appellees.
North Carolina Commissioner of Banks, Amicus Curiae,
The Chamber of Commerce of the United States of America; American Association of Bank Directors; Independent Community Bankers of America; The Clearing House Association, LLC; American Bankers Association; Alabama Bankers Association; Alaska Bankers Association; Arizona Bankers Association; Arkansas Bankers Association; California Bankers Association; Colorado Bankers Association; Connecticut Bankers Association; Delaware Bankers Association; Florida Bankers Association; Georgia Bankers Association; Hawaii Bankers Association; Heartland Community Bankers Association; Idaho Bankers Association; Illinois Bankers Association; Illinois League of Financial Institutions; Indiana Bankers Association; Iowa Bankers Association; Kansas Bankers Association; Kentucky Bankers Association; Louisiana Bankers Association; Maine Bankers Association; Maryland Bankers Association; Massachusetts Bankers Association; Michigan Bankers Association; Minnesota Bankers Association; Mississippi Bankers Association; Missouri Bankers Association; Montana Bankers Association; Nebraska Bankers Association; Nevada Bankers Association; New Hampshire Bankers Association; New Jersey Bankers Association; New Mexico Bankers Association; New York Bankers Association; North Carolina Bankers Association; North Dakota Bankers Association; Ohio Bankers League; Oklahoma Bankers Association; Oregon Bankers Association; Pennsylvania Bankers Association; Puerto Rico Bankers Association; Rhode Island Bankers Association; South Carolina Bankers Association; South Dakota Bankers Association; Tennessee Bankers Association; Texas Bankers Association; Vermont Bankers Association; Virginia Bankers Association; Utah Bankers Association; Washington Bankers Association; Washington Financial League; West Virginia Bankers Association; Wisconsin Bankers Association; Wyoming Bankers Association, Amici Supporting Appellees.

No. 14–2078. | Argued: May 13, 2015. | Decided: Aug. 18, 2015.

Synopsis
Background: Federal Deposit Insurance Corporation (FDIC), as receiver for failed bank, brought action against bank's former directors and officers, asserting claims for gross negligence, negligence, and breach of fiduciary duty. Following denial of defendants' motion to dismiss, 882 F.Supp.2d 859, defendants moved for summary judgment and FDIC filed cross-motion for partial summary judgment. The United States District Court for the Eastern District of North Carolina, Terrence W. Boyle, J., 48 F.Supp.3d 844, granted summary judgment in favor of defendants, and FDIC appealed.

Holdings: The Court of Appeals, Gregory, Circuit Judge, held that:

[1] under North Carolina law, exculpatory clause in bank's articles of incorporation protected directors from monetary liability as to FDIC's claims of ordinary negligence and breach of the fiduciary duty of good faith;

[2] FDIC presented sufficient evidence to rebut the initial evidentiary presumption of the business judgment rule, that bank's officers acted on an informed basis;

[3] under North Carolina law, "gross negligence" generally refers to wanton conduct done with conscious or reckless disregard for the rights and safety of others;

[4] FDIC failed to demonstrate that officers' actions were grossly negligent;

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F.D.I.C. ex rel. Co-op. Bank v. Rippy, 799 F.3d 301 (2015)
2015 WL 4910473

> [The business judgment rule] operates primarily as a rule of evidence or judicial review and creates, first, an initial evidentiary presumption that in making a decision the directors acted with due care (i.e., on an informed basis) and in good faith in the honest belief that their action was in the best interest of the corporation, and second, absent rebuttal of the initial presumption, a powerful substantive presumption that a decision by a loyal and informed board will not be overturned by a court unless it cannot be attributed to any rational business purpose.

State ex rel. Long v. ILA Corp., 132 N.C.App. 587, 513 S.E.2d 812, 821–22 (1999) (quoting Russell M. Robinson, II, *Robinson on North Carolina Corporation Law* § 14.06, at 281 (5th ed.1995)) (alteration in original). "[P]roper analysis" of an officer's or director's actions "requires examination of [those] actions in light of the statutory protections of N.C. Gen.Stat. § 55–8–30(d)(1990)(amended 1993) and the business judgment rule, either or both of which could potentially insulate him from liability." Id. at 821. Indeed, Robinson suggests that "a director may be protected by the business judgment rule even if he fails to meet the prescribed standards of conduct" set forth in North Carolina's statute. Robinson, *Robinson on North Carolina Corporation Law* § 14.06 n. 2.

**6 With this framework in mind, we turn to the FDIC–R's claims.

A.

[12] We consider director liability first. Cooperative's articles of incorporation include an exculpatory provision, as permitted by N.C.G.S. § 55–2–02(b)(3):

> A director of the Bank shall not be personally liable to the Bank or its shareholders for monetary damages for breach of any fiduciary duty as a director; provided, however, that this limitation of liability shall not be effective with respect to (i) acts or omissions that the director at the time of such breach knew or believed were *clearly* in conflict with the best interests of the Bank....

J.A. 683 (emphasis supplied). In accordance with § 55–2–02(b)(3), the exculpatory provision in the Bank's articles of incorporation does not eliminate liability for breaches of the duty of loyalty or the duty of good faith. Nor does the provision eliminate liability for gross negligence.

The FDIC–R does not contend that the Director Appellees breached a duty of loyalty. Thus, unless there is a genuine issue of material fact as to whether the Director Appellees breached their duty of good faith, the exculpatory provision will protect them from liability for ordinary negligence and breach of fiduciary duties.

[13] Under North Carolina law, "the duty of good faith requires [corporate] directors to avoid self-dealing." *ILA Corp.*, 513 S.E.2d at 819. Here, there is no allegation or evidence in the record that the directors engaged in self-dealing or fraud or otherwise acted in bad faith. Rather, the FDIC–R argues only that the evidence suggests that the Director Appellees took actions harmful to the Bank, in part by making decisions without adequate information. This is insufficient. The exculpatory clause protects directors from monetary liability unless the directors "knew or believed [that their acts or omissions] were *clearly* in conflict" with the Bank's best interests. N.C.G.S. § 55–2–02(b)(3) (emphasis *313 added). Actions that might have been harmful or decisions that could have been better made do not rise to the level of bad faith in this context, especially in light of the fact that the Bank received CAMELS scores of "2" from both of its regulators despite the Director Appellees' actions. We find that the FDIC–R has not presented sufficient evidence of a breach of the duty of good faith to raise a genuine issue of material fact.

We therefore affirm the district court's award of summary judgment to the Director Appellees as to the FDIC–R's claims of ordinary negligence and breach of fiduciary duty.

B.

We turn next to officer liability. The Bank's exculpatory provision does not cover Bank officers. Thus, we analyze

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[13] Under North Carolina law, "the duty of good faith requires [corporate] directors to avoid self-dealing." *ILA Corp.*, 513 S.E.2d at 819. Here, there is no allegation or evidence in the record that the directors engaged in self-dealing or fraud or otherwise acted in bad faith. Rather, the FDIC–R argues only that the evidence suggests that the Director Appellees took actions harmful to the Bank, in part by making decisions without adequate information. This is insufficient. The exculpatory clause protects directors from monetary liability unless the directors "knew or believed [that their acts or omissions] were *clearly* in conflict" with the Bank's best interests. N.C.G.S. § 55–2–02(b)(3) (emphasis ***313** added). Actions that might have been harmful or decisions that could have been better made do not rise to the level of bad faith in this context, especially in light of the fact that the Bank received CAMELS scores of "2" from both of its regulators despite the Director Appellees' actions. We find that the FDIC–R has not presented sufficient evidence of a breach of the duty of good faith to raise a genuine issue of material fact.

John E. Johnson JOHNSON & CASSIDY

Reexamining the Standard of Care

- Florida's Business Judgment Rule does not provide a heightened level of protection for directors acting in the capacity as officers.

- *FDIC v. Brudnicki*, No. 5:12-cv-398-RS-GRJ, 2013 WL 2145720 (N.D. Fla. May 15, 2013).

Reexamining the Standard of Care

Case 5:12-cv-00398-RS-GRJ Document 10 Filed 05/15/13 Page 1 of 11

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IN THE UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF FLORIDA
PANAMA CITY DIVISION

FEDERAL DEPOSIT INSURANCE CORPORATION,

Plaintiff,

v. CASE NO. 5:12-cv-398-RS-GRJ

GREG M. BRUDNICKI, et al.,

Defendants.
____________________________________/

ORDER

Before me are Defendants' Motion to Dismiss, Strike, or for More Definite Statement (Doc. 3) and Plaintiff's Response (Doc. 5).

Standard of Review

To overcome a motion to dismiss, a plaintiff must allege sufficient facts to state a claim for relief that is plausible on its face. *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). Granting a motion to dismiss is appropriate if it is clear that no relief could be granted under any set of facts that could be proven consistent with the allegations of the complaint. *Hishon v. King & Spalding*, 467 U.S. 69, 104 S. Ct. 2229, 2232 (1984). I must construe all allegations in the complaint as true and in the light most favorable to the plaintiff. *Shands Teaching Hosp. and Clinics, Inc. v. Beech Street Corp.*, 208 F.3d 1308, 1310 (11th Cir. 2000) (citing *Lowell v. American Cyanamid Co.*, 177 F.3d 1228, 1229 (11th Cir. 1999)).

Case 5:12-cv-00398-RS-GRJ Document 10 Filed 05/15/13 Page 4 of 11

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nothing in the statute that suggests that a director who is also in officer should be deprived if its protection. Interpreting the statute during its infancy,[1] one federal district court found "that the Florida statute insulates corporate directors and officers . . . ." *F.D.I.C. v. Gonzalez-Gorrondona*, 833 F. Supp. 1545, 1556 (S.D. Fla. 1993). Also, in a case where the statute did not apply, the Eleventh Circuit stated in a footnote that "[t]he Florida legislature passed Fla. Stat. § 607.1645 (1987), presently codified at Fla. Stat. §§ 607.0830, 607.0831 (1989), to afford corporate officers and directors greater protection from liability." *F.D.I.C. v. Stahl*, 89 F.3d 1510, 1516 (11th Cir. 1996).

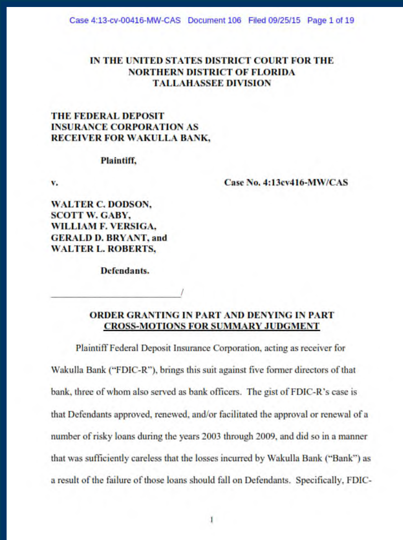
However, I find that the statute does not afford the same protections to officers as it does to directors. In the very same act that created section 607.1645, the precursor to section 607.0831, the legislature added a section with parallel language to the statute allowing corporations to indemnify officers, directors, employees, and agents. To this section the legislature added, "indemnification or advancement of expenses shall not be made to or on behalf of any director, officer, employee, or agent if a judgment or other final adjudication establishes that his or her actions, or omissions to act, were material to the cause of action so adjudicated and constitute. . . **[w]illful misconduct or a conscious disregard for the best interests of the corporation.**" Fla. Stat. §607.014(7)(d) (1987), now codified at Fla. Stat. §607.0850(7)(d) (1989) (emphasis added). The standard to impose director liability was, and remains, **"conscious disregard for the best interest of the corporation, or willful misconduct."** Fla. Stat. § 607.0831(1)(b)(4) (emphasis

[1] The statute became effective July 1, 1987. Prior to that time, directors were liable for ordinary negligence. *F.D.I.C. v. Gonzalez-Gorrondona*, 833 F. Supp. 1545, 1555 (S.D. Fla. 1993).

However, I find that the statute does not afford the same protections to officers as it does to directors. In the very same act that created section 607.1645, the precursor to section 607.0831, the legislature added a section with parallel language to the statute allowing corporations to indemnify officers, directors, employees, and agents. To this section the legislature added, "indemnification or advancement of expenses shall not be made to or on behalf of any director, officer, employee, or agent if a judgment or other final adjudication establishes that his or her actions, or omissions to act, were material to the cause of action so adjudicated and constitute. . . **[w]illful misconduct or a conscious disregard for the best interests of the corporation.**" Fla. Stat. §607.014(7)(d) (1987), now codified at Fla. Stat. §607.0850(7)(d) (1989) (emphasis added). The standard to impose director liability was, and remains, **"conscious disregard for the best interest of the corporation, or willful misconduct."** Fla. Stat. § 607.0831(1)(b)(4) (emphasis

Reexamining the Standard of Care

- Officers on Directors' Loan Committee are held to officer standard of care; *FDIC v. Dodson*, No. 4:13-cv-416-MW-CAS, (N.D. Fla. September 25, 2015).



Case 4:13-cv-00416-MW-CAS Document 106 Filed 09/25/15 Page 1 of 19

IN THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF FLORIDA TALLAHASSEE DIVISION

THE FEDERAL DEPOSIT INSURANCE CORPORATION AS RECEIVER FOR WAKULLA BANK,

Plaintiff,

v. **Case No. 4:13cv416-MW/CAS**

WALTER C. DODSON, SCOTT W. GABY, WILLIAM F. VERSIGA, GERALD D. BRYANT, and WALTER L. ROBERTS,

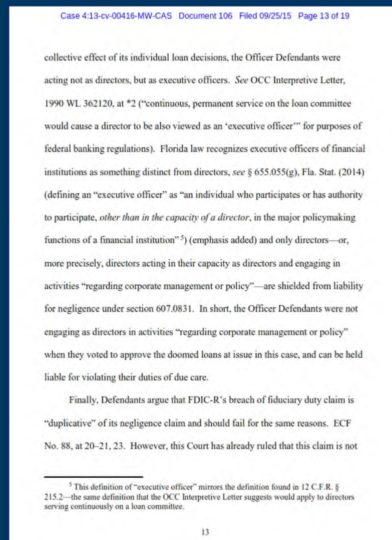
Defendants.

_____________________________/

ORDER GRANTING IN PART AND DENYING IN PART CROSS-MOTIONS FOR SUMMARY JUDGMENT

Plaintiff Federal Deposit Insurance Corporation, acting as receiver for Wakulla Bank ("FDIC-R"), brings this suit against five former directors of that bank, three of whom also served as bank officers. The gist of FDIC-R's case is that Defendants approved, renewed, and/or facilitated the approval or renewal of a number of risky loans during the years 2003 through 2009, and did so in a manner that was sufficiently careless that the losses incurred by Wakulla Bank ("Bank") as a result of the failure of those loans should fall on Defendants. Specifically, FDIC-

1



Case 4:13-cv-00416-MW-CAS Document 106 Filed 09/25/15 Page 13 of 19

collective effect of its individual loan decisions, the Officer Defendants were acting not as directors, but as executive officers. *See* OCC Interpretive Letter, 1990 WL 362120, at *2 ("continuous, permanent service on the loan committee would cause a director to be also viewed as an 'executive officer'" for purposes of federal banking regulations). Florida law recognizes executive officers of financial institutions as something distinct from directors, *see* § 655.055(g), Fla. Stat. (2014) (defining an "executive officer" as "an individual who participates or has authority to participate, *other than in the capacity of a director*, in the major policymaking functions of a financial institution"[5]) (emphasis added) and only directors—or, more precisely, directors acting in their capacity as directors and engaging in activities "regarding corporate management or policy"—are shielded from liability for negligence under section 607.0831. In short, the Officer Defendants were not engaging as directors in activities "regarding corporate management or policy" when they voted to approve the doomed loans at issue in this case, and can be held liable for violating their duties of due care.

Finally, Defendants argue that FDIC-R's breach of fiduciary duty claim is "duplicative" of its negligence claim and should fail for the same reasons. ECF No. 88, at 20–21, 23. However, this Court has already ruled that this claim is not

[5] This definition of "executive officer" mirrors the definition found in 12 C.F.R. § 215.2—the same definition that the OCC Interpretive Letter suggests would apply to directors serving continuously on a loan committee.

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for negligence under section 607.0831. In short, the Officer Defendants were not engaging as directors in activities "regarding corporate management or policy" when they voted to approve the doomed loans at issue in this case, and can be held liable for violating their duties of due care.

John E. Johnson JC JOHNSON & CASSIDY

Business Judgment Rule

- **Delaware:** The business judgment rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interest of the company." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). "The Delaware business judgement rule 'operates *both* as a procedural guide for litigations and as a substantive rule of law.'" *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1162 (Del. 1995).

- **Georgia:** The business judgment rule "generally precludes claims against officers and directors for their business decisions that sound in ordinary negligence, except to the extent that those decisions are shown to have been made without deliberation, without the requisite diligence to ascertain and assess the facts and circumstances upon which the decisions are made, or in bad faith." *See FDIC v. Loudermilk*, 761 S.E.2d 332, 338 (2014).

Business Judgment Rule

- Directors and officers should carefully document their business judgments, focusing not only on the ultimate decision but also on the decision-making process (process vs. substance).
- Meeting minutes should reflect the robust debate over a decision when it happens, including any decision not to act.
- Documents should reflect that decision-makers gathered and evaluated information in ways that are standard to their industry and with sufficient time to review.

Business Judgment Rule

- Boards should seek advice from third-party consultants or legal counsel about whether their information-gathering and decisional processes adhere to industry norms.

- If you decide to change course, make sure the change is clear and in writing.

- Banks should also develop protocols for ensuring that directors and officers have sufficient time to review information before making decisions.

- Memorialize process and decisions through robust documentation.

Due Diligence on New Borrowers

- Due diligence on new borrowers is critical
- Know your borrower!
  - What is his experience? Expertise?
    - If borrower lacks experience, expertise, how will he mitigate?
  - Conduct on-site visits of project areas; beware of out-of-market projects
  - Require criminal background check

Due Diligence on New Borrowers

- Know your borrower's assets
  - Verify claimed assets
    - Call other financial institutions
    - Require real estate appraisals
    - Consider audited financial statements for larger borrowers
  - If borrower is a newly formed entity, require proof that the entity is adequately capitalized
    - Consider requiring principal(s) to sign on as guarantor(s)

Due Diligence on New Borrowers

- Know your borrower's assets
  - Require global cash flow analysis
    - Should include <u>all</u> liabilities and contingent liabilities
  - Stress test borrower's ability to support loan
    - Know how long the borrower can support the loan if the market crashes

Due Diligence on New Borrowers

- Red flags for new borrowers
  - Personal wealth highly concentrated in real estate, closely-held businesses
  - Low cash holdings, high debt
  - Discrepancies between tax returns and financial statements
  - Reluctance to provide documentation or verification of claimed assets

Make Sure Your Bank Has Checks and Balances

- Do not comingle loan production and credit risk management functions
  - Common for small and de novo banks to have one officer oversee loan production and credit risk management
  - As these banks grow, however, it is critical that these two functions be separated to avoid a conflict of interest. Too easy to maintain a "small bank" credit risk structure with a "big bank" portfolio.

- Avoid incentivizing loan production
  - Performance bonuses should not be tied to loan production. This invites loan officers to overlook red flags.

Make Sure Your Bank Has Checks and Balances

- Avoid concentrating power or institutional knowledge
  - Be wary of a "strongman" in charge of the bank. Often a bank's founder will place close friends on the Board in an attempt to run the bank unilaterally. Recognize that D&Os have a duty to act independently.
  - Also beware of an officer with a concentration of power (e.g., loan approval authority) or institutional knowledge. Require committee approvals for large loans. Consider having succession plans in place for executive and key officers in case they leave the bank or become ill.

Negotiating Settlements with FDIC

Rule Number 1 – Don't expect consistency

- Resist FDIC claims of "approved" form of settlement agreements – in practice, key provisions in agreements vary significantly
- Supervisory counsel in D.C. generally with greater flexibility regarding terms and conditions than field counsel
- Insurers influence final terms and conditions and may negotiate separately from officers and directors on a "global" basis

Negotiating Settlements with FDIC

Rule Number 2 – Politics can have an effect

- FDIC's change from accepting proceeds of insurance to requiring personal contributions by officers and directors
- Expediency of settlements vs. trials; still only one case (IndyMac) that has gone to trial
- Congressional backlash against FDIC heavy-handedness in pursuing claims against officers and directors

Negotiating Settlements with FDIC

Rule Number 3 – Facts Do Make a Difference

- The Courts criticize FDIC's claims that the "Great Recession" was foreseeable by officers and directors
- The FDIC's investigation into the bank's failure may not have been well-coordinated or supervised; original loan documents lost or destroyed
- Post-receivership events may a have significant effect upon FDIC's allegations of negligence and losses sustained by bank
  - Ultimate build-out of real estate developments with accompanying sales of units demonstrates intervening cause for bank's losses
  - Foreclosures by acquiring bank and subsequent sale of collateral for amounts in excess of amounts shown on bank's books at closure
  - Loss-share agreements

Negotiating Settlements with FDIC

Key Provisions – How much do I pay?

- Insurance proceeds only, or is a personal contribution required?
- Are you jointly and severally liable for payment; is it a "collective" obligation?
- Is there an agreement between the officers and directors regarding monetary contributions toward the settlement amount?

Negotiating Settlements with FDIC

Key Provisions – Who is released?

- Are all officers and directors of failed bank released or only the settling defendants?
- Do the officers and directors release the insurer from further liability under the D&O policy?
- Will the FDIC as Receiver also release the FDIC in its corporate capacity?

Negotiating Settlements with FDIC

Key Provisions – Is it truly over?

- Is there an obligation of the officers and directors to provide continuing cooperation to the FDIC?
- What happens if payment is not received by FDIC?
- Did the officers and directors make a representation regarding their financial condition?

MINIMIZING BANK OFFICER & DIRECTOR LIABILITY
IN AN ERA OF HEIGHTENED SECURITY

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PROTECTING CONFIDENTIAL INFORMATION

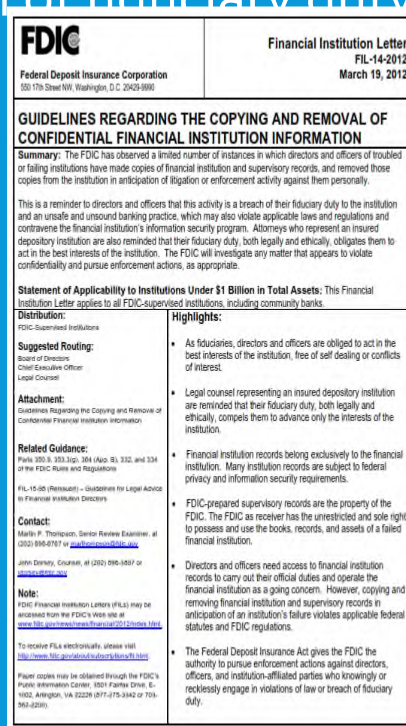
BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- Maintaining certain bank records is a violation of Financial Institution Letter 14-2012.
- Copies of financial institution and supervisory records made and removed from the institution in anticipation of litigation or enforcement activity is a breach of fiduciary duty and unsafe and unsound banking practice.

by your clients that they did not have any Bank documents in their possession. However, last week, you produced copies of 832 pages of confidential, internal bank records which were apparently copied from the Bank's files and maintained by your clients in violation of Financial Institution Letter 14-2012. These documents include (1) sensitive, non-public personal identifying information ("PII") involving the Bank's customers, such as would be contained in loan files, internal loan committee minutes, various loan reports and spreadsheets and other loan- and finance-related documents, such as appraisals, guarantees, financial statements, tax returns and credit reports; (2) examination, supervisory, operation or condition reports prepared by or exchanged between the Bank and various regulatory agencies, all of which are confidential and exempt from disclosure; and (3) Suspicious Activity Reports ("SAR's") (the hard drive images and all other information and records of the Bank are collectively referred to hereinafter as the "Bank Records").

BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- Financial Institution Letter 14-2012: Copies of financial institution and supervisory records made and removed from the institution in anticipation of litigation or enforcement activity is a breach of fiduciary duty and unsafe and unsound banking practice.



FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-14-2012
March 19, 2012

GUIDELINES REGARDING THE COPYING AND REMOVAL OF CONFIDENTIAL FINANCIAL INSTITUTION INFORMATION

Summary: The FDIC has observed a limited number of instances in which directors and officers of troubled or failing institutions have made copies of financial institution and supervisory records, and removed those copies from the institution in anticipation of litigation or enforcement activity against them personally.

This is a reminder to directors and officers that this activity is a breach of their fiduciary duty to the institution and an unsafe and unsound banking practice, which may also violate applicable laws and regulations and contravene the financial institution's information security program. Attorneys who represent an insured depository institution are also reminded that their fiduciary duty, both legally and ethically, obligates them to act in the best interests of the institution. The FDIC will investigate any matter that appears to violate confidentiality and pursue enforcement actions, as appropriate.

Statement of Applicability to Institutions Under $1 Billion in Total Assets: This Financial Institution Letter applies to all FDIC-supervised institutions, including community banks.

Distribution:
FDIC-Supervised Institutions

Suggested Routing:
Board of Directors
Chief Executive Officer
Legal Counsel

Attachment:
Guidelines Regarding the Copying and Removal of Confidential Financial Institution Information

Related Guidance:
Parts 350.9, 353.3(g), 364 (App. B), 332, and 334 of the FDIC Rules and Regulations

FIL-15-95 (Reissued) – Guidelines for Legal Advice to Financial Institution Directors

Contact:
Martin P. Thompson, Senior Review Examiner, at (202) 898-6767 or marthompson@fdic.gov

John Dorsey, Counsel, at (202) 898-3807 or jdorsey@fdic.gov

Note:
FDIC Financial Institution Letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2012/index.html.

To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (877-275-3342 or 703-562-2200).

Highlights:

- As fiduciaries, directors and officers are obliged to act in the best interests of the institution, free of self dealing or conflicts of interest.
- Legal counsel representing an insured depository institution are reminded that their fiduciary duty, both legally and ethically, compels them to advance only the interests of the institution.
- Financial institution records belong exclusively to the financial institution. Many institution records are subject to federal privacy and information security requirements.
- FDIC-prepared supervisory records are the property of the FDIC. The FDIC as receiver has the unrestricted and sole right to possess and use the books, records, and assets of a failed financial institution.
- Directors and officers need access to financial institution records to carry out their official duties and operate the financial institution as a going concern. However, copying and removing financial institution and supervisory records in anticipation of an institution's failure violates applicable federal statutes and FDIC regulations.
- The Federal Deposit Insurance Act gives the FDIC the authority to pursue enforcement actions against directors, officers, and institution-affiliated parties who knowingly or recklessly engage in violations of law or breach of fiduciary duty.

BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- Bank Records and Examination Reports are Confidential

First, examination, supervisory, operation or condition reports prepared by the FDIC or other bank regulators and/or exchanged with the Bank ("Reports") are confidential and exempt from disclosure. *See, e.g.* 12 C.F.R. §§ 309.4. 309.5, 309.6 and 350.0. Similarly, extraordinary protections and treatment are afforded to SAR's. The mandate to keep SAR's and the information contained therein confidential, and thus strictly internal to a bank and its regulators, is set forth in 31 U.S.C. § 5318; *see also* 12 C.F.R. §§ 208.20G), 208.62 and 353.3(g). In fact, the level of confidentiality afforded to SAR's is so high that they are generally immune from discovery in civil proceedings. *Whitney Nat'l Bank v. Karaim,* 306 F.Supp.2d 678, 682 (S.D. Tex. 2004); *Weil v. Long Island Savings Balik,* 195 F.Supp.2d 383,389 (E.D.N.Y. 2001).

BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- Pursuant to 12 C.F.R. § 350.9, reports of examination or supervisory activity prepared by the FDIC may not be disclosed.

§ 350.9 Disclosure of examination reports.

Except as permitted under specific provisions of the FDIC's regulations (12 CFR Part 309), a bank may not disclose any report of examination or report of supervisory activity or any portion thereof prepared by the FDIC. The bank also shall not make any representation concerning such report or the findings therein.

[Codified to 12 C.F.R. § 350.9]

BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- Suspicious Activity Reports ("SARS") are confidential and not disclosed or produced.
- 12 C.F.R. § § 208.62(j), 353.3(g)

(j) *Confidentiality of SARs.* SARs are confidential. Any member bank subpoenaed or otherwise requested to disclose a SAR or the information contained in a SAR shall decline to produce the SAR or to provide any information that would disclose that a SAR has been prepared or filed citing this section, applicable law (e.g., 31 U.S.C. 5318(g)), or both, and notify the Board.

(g) *Confidentiality of suspicious activity reports.* Suspicious activity reports are confidential. Any bank subpoenaed or otherwise requested to disclose a suspicious activity report or the information contained in a suspicious activity report shall decline to produce the suspicious activity report or to provide any information that would disclose that a suspicious activity report has been prepared or filed citing this part, applicable law (e.g., 31 U.S.C. 5318(g)), or both, and notify the appropriate FDIC regional office (Division of Supervision).

BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- Maintaining Electronic Copies of Bank Records May Violate the Computer Fraud and Abuse Act.

Second, the accessing, copying, removal, distribution and continuing unlawful possession of Bank Records in electronic format may also violate the Computer Fraud and Abuse Act. 18 U.S.C. §1030(a)(2). This statute protects the Bank from unauthorized disclosure of such records, for example, by making it illegal to access information contained in a financial record of a financial institution through a computer. The punishment for a violation of 18 U.S.C. § 1030(a) includes up to five years in prison. 18 U.S.C. § 1030(c)(I)(B). Under 18 U.S.C. § 641, it is a separate crime to convert government records to personal use. The statute covers both the tangible records and the intangible information they contain. *United Slates v. Lambert, 446* F.Supp. 890. 895 (D. Conn. 1978).

BANK RECORDS CONTAINING PERSONAL IDENTIFYING INFORMATION

- "Whoever, (2) intentionally accesses a computer without authorization or exceeds authorized access, and thereby obtains – (a) information contained in a financial record of a financial institution, or of a card issuer as defined in section 1602(n) of title 15, or contained in a file of a consumer reporting agency on a consumer, as such terms are defined in the Fair Credit Reporting Act (15 U.S.C. 1681 et seq.) […] shall be punished as provided in subsection (c) of this section. 18 U.S.C. § 1030(a)(2).

BANK RECORDS CONTAIN PERSONAL IDENTIFYING INFORMATION

- Bank Records are Confidential

Third, as noted above, many of the Bank Records that your clients maintained and which apparently are in your possession undoubtedly contain sensitive, nonpublic PII. The Bank was required to protect the secrecy and confidentiality of that PII pursuant to various statues,

regulations and internal Bank policies, including, but not limited to, the Gramm-Leach-Bliley Act, 15 U.S.C. §§ 6801, 6802 & 6805(b); the Federal Deposit Insurance Act, 12 U.S.C. § 1821p-1; the Bank Secrecy Act, 31 U.S.C. § 5318(g); and certain FDIC regulations, 12 C.F.R. Parts 332 and 364. Importantly, the FDIC-R is now charged with protecting this same PII. Yet, neither the FDIC-R nor the Bank's customers are properly consenting to the accessing, copying, prior removal, possession, distribution or use of these Bank Records by you, your firm, or your clients. Thus, any such actions therefore potentially constitute violations of the above-referenced statutes, regulations and policies which were enacted and adopted to protect the PII of the Bank's customers and could lead to substantial damages to the FDIC-R, for which you, your firm, and your clients ultimately could be held responsible.

BANK RECORDS CONTAIN PERSONAL IDENTIFYING INFORMATION

- Bank Records are Confidential; Penalties

By retaining Bank Records which include the above-described Reports and SAR's, you, your firm, and your clients are violating the regulations that protect the confidentiality of those documents. Injunctive relief to remedy the violation of these statutes is expressly provided in 12 U.S.C. § 1954. Additionally, monetary penalties of $25,000 per day for each SAR violation is authorized under 31 U.S.C. § 5321(a).

Second, the accessing, copying, removal, distribution and continuing unlawful possession of Bank Records in electronic format may also violate the Computer Fraud and Abuse Act. 18 U.S.C. §1030(a)(2). This statute protects the Bank from unauthorized disclosure of such records, for example, by making it illegal to access information contained in a financial record of a financial institution through a computer. The punishment for a violation of 18 U.S.C. § 1030(a) includes up to five years in prison. 18 U.S.C. § 1030(c)(I)(B). Under 18 U.S.C. § 641, it is a separate crime to convert government records to personal use. The statute covers both the tangible records and the intangible information they contain. *United Slates v. Lambert, 446* F.Supp. 890. 895 (D. Conn. 1978).

BANK RECORDS CONTAIN PERSONAL IDENTIFYING INFORMATION

- Monetary penalties of $25,000 per day for each SAR violation under 31 U.S.C. § 5321(a).

31 U.S.C.A. § 5321

§ 5321. Civil penalties

Effective: October 23, 2004
Currentness

(a)(1) A domestic financial institution or nonfinancial trade or business, and a partner, director, officer, or employee of a domestic financial institution or nonfinancial trade or business, willfully violating this subchapter or a regulation prescribed or order issued under this subchapter (except sections 5314 and 5315 of this title or a regulation prescribed under sections 5314 and 5315), or willfully violating a regulation prescribed under section 21 of the Federal Deposit Insurance Act or section 123 of Public Law 91-508, is liable to the United States Government for a civil penalty of not more than the greater of the amount (not to exceed $100,000) involved in the transaction (if any) or $25,000. For a violation of section 5318(a)(2) of this title or a regulation prescribed under section 5318(a)(2), a separate violation occurs for each day the violation continues and at each office, branch, or place of business at which a violation occurs or continues.

BANK RECORDS CONTAIN PERSONAL IDENTIFYING INFORMATION

- Imprisonment up to 5 years in prison under 18 U.S.C. § 1030(c)(1)(B).

(c) The punishment for an offense under subsection (a) or (b) of this section is—

(1)

(A) a fine under this title or imprisonment for not more than ten years, or both, in the case of an offense under subsection (a)(1) of this section which does not occur after a conviction for another offense under this section, or an attempt to commit an offense punishable under this subparagraph; and

(B) a fine under this title or imprisonment for not more than twenty years, or both, in the case of an offense under subsection (a)(1) of this section which occurs after a conviction for another offense under this section, or an attempt to commit an offense punishable under this subparagraph;

(2)

(A) except as provided in subparagraph (B), a fine under this title or imprisonment for not more than one year, or both, in the case of an offense under subsection (a)(2), (a)(3), or (a)(6) of this section which does not occur after a conviction for another offense under this section, or an attempt to commit an offense punishable under this subparagraph;

(B) a fine under this title or imprisonment for not more than 5 years, or both, in the case of an offense under subsection (a)(2), or an attempt to commit an offense punishable under this subparagraph, if—

(i) the offense was committed for purposes of commercial advantage or private financial gain;

(ii) the offense was committed in furtherance of any criminal or tortious act in violation of the Constitution or laws of the United States or of any State; or

(iii) the value of the information obtained exceeds $5,000; and

(C) a fine under this title or imprisonment for not more than ten years, or both, in the case of an offense under subsection (a)(2), (a)(3) or (a)(6) of this section which occurs after a conviction for another offense under this section, or an attempt to commit an offense punishable under this subparagraph;

Slide 53

MP2 I think this cite in Crandall's letter is wrong - maybe should be (c)(2)(B)

Michelle Patel, 1/5/2016

Minimizing Bank Officer & Director Liability

In an Era of Heightened Regulatory Scrutiny

Charles L. Stutts

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Holland & Knight

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Hot Topics for Bank Officers and Directors

Staying on Top of Cybersecurity

Risks to Banks (and their Directors and Officers) from Cyber attacks

- Capital risks – loss of money
- Compliance risk – regulatory action
- Reputational risks – loss of consumer confidence
- Operational risks – inability to deliver products and services

Staying on Top of Cybersecurity

Interagency Guidelines Establishing Information Security Standards

- Information Security Program
  - Administrative, technical and physical safeguards
  - Appropriate to size and complexity of bank
  - Appropriate to nature and scope of activities
- Development and Implementation – Components
  - Board should approve and oversee
  - Assess risk – foreseeable internal and external threats
  - Manage and control risk
  - Oversee service provider arrangement
  - Audit and adjust the Program

Staying on Top of Cybersecurity

FFIEC Cybersecurity Assessment Tool

- Identification of risks and determination of cybersecurity preparedness (i.e., risk profile)
- Principles derived from FFIEC Information Technology Examination Handbook/NIST Cybersecurity Framework
- Intended results - enhanced risk management practices and controls

Staying on Top of Cybersecurity

Incident Response Program

- Team members, roles, communication channels and notification requirements
- Defining what constitutes an "incident"
- Specific procedures
  - Categorizing and prioritizing incident
  - Response mechanisms; forensic analysis, containment, etc.
  - Internal and external communications
  - Mitigate operational impact and loss or corruption of data
  - Business continuity and recovery
- Post-incident activity and lessons learned

Staying on Top of Cybersecurity

FFIEC Statement – Increasing Frequency and Severity of Cyber Attacks Involving Extortion (November 3, 2015)

- Ransomware – Malicious software that infects computer system and restricts access to key data or key systems unless "ransom" is paid
- SARs filed in event of unauthorized intrusion intended to damage, disable or affect critical systems
- Incident Response Policies and Procedures in event of unauthorized access to customer information

Recent Enforcement and Regulatory Activities

Part I – Actions by FDIC as Receiver

- Under FDIC's policy statement, actions must be both "meritorious" and "expected to be cost-effective"
- Gross negligence is the standard unless state law allows suits against D&Os for simple negligence
- Three year SOL for tort claims
- FDIC policy statement states that business judgment may be exercised without incurring liability

Recent Enforcement and Regulatory Activities

Part I – Actions by FDIC as Receiver

- FDIC authorized lawsuits against 26 officers and directors in 2015 (according to website)
- 3 lawsuits filed against a total of 32 D&Os
  - FDIC as Receiver for Patriot Bank Minnesota v. Milbauer, et al., Case No. 15-cv-00434 (D. Minn. February 3, 2015)
  - FDIC as Receiver for New City Bank v. Baldermann, et al., Case No. 15-cv-02027 (N.D. Ill. March 6, 2015)
  - FDIC as Receiver for Montgomery Bank & Trust v. Champion, et al., Case No. 15-cv-00058 (S.D. Ga. July 1, 2015).
- No reflection of authorization to commence suits against additional D&Os in 2016
- One 2015 lawsuit settled (Baldermann)

Recent Enforcement and Regulatory Activities

Part I – Actions by FDIC as Receiver

- FDIC v. Mibauer, et al.
  - President/CEO and Members of Directors' Loan Committee
  - Negligence, gross negligence, and breach of fiduciary duties in originating and approving CRE loans
  - 14 loans between 11/15/05 – 12/31/08
  - Inadequate analysis of financial data of borrowers and guarantors; CRE loans both exceeded concentration limits and loan to value (LTV) ratios set forth in loan policy
  - $8.02 million alleged losses
  - Defendants with alleged "knowledge" of "boom and bust" cycles in real estate

Recent Enforcement and Regulatory Activities
Part I – Actions by FDIC as Receiver

- FDIC v. Baldermann, et al.
  - CEO/Chairman of all other members of Board of Directors
  - Negligence, gross negligence and breach of fiduciary duties in approving "high risk" loans (CRE)
  - 13 loans between 3/06 – 9/08
  - Inadequate analysis of financial data regarding borrowers; CRE loans exceed LTV ratios in loan policy
  - $6.6 million alleged losses
- Case settled May 7, 2015
  - $2,500,000 settlement payment
  - Defendants and insurer were "jointly and severally" liable for payment
  - FDIC-R released not only settling defendants, but also all former D&Os of Bank
  - FDIC in corporate capacity not released
  - Financial representations by defendants

Recent Enforcement and Regulatory Activities

Part I – Actions by FDIC as Receiver

- FDIC v. Champion, et al
  - CEO/Chairman/Directors/COO
  - Negligence, gross negligence, and breach of fiduciary duties in allowing "non-party" to misappropriate $14.7 million from Bank
  - Misappropriations occurred between January 2011 – May 2012
  - Bank under C&D at time of theft
  - "Non-party" the controlling shareholder of Bank and former Director
  - Funds transferred to securities account under control of non-party, who lost the funds in risky securities trades
- FDIC settled claims against former director, Guy Campbell, 11/13/05
  - $200,000 settlement payment
  - No insurer payment
  - Terms and conditions consistent with Baldermann

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- Institution-Affiliated Parties - May also involve removal/prohibition actions
- Three tiers of CMPs
  - First tier only requires proof of a violation of law or regulation, or of a final order
  - Second tier requires proof that IAP recklessly engaged in unsafe or unsound practices or breach of fiduciary duty;
    - Violation, practice or breach must be part of a pattern of misconduct, causes loss to bank, or results in pecuniary gain
  - Third tier requires proof of a knowing violation, practice or breach
- Penalties increase from Tier 1 to Tier 3
  - Tier 1 – up to $5,000 per day
  - Tier 2 – up to $25,000 per day
  - Tier 3 – up to $1 million per day

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- Focus on Tier II penalties (up to $25,000 per day) – 12 U.S.Code 1818(i)(2)(B)
- Tier II elements characterized as (i) misconduct, (ii) effects, and (iii) culpability (see, Dodge v. Comptroller of the Currency, 744 F.3d 148, 152 (D.C. Cir. 2014)
- Misconduct:
  - Violation of law, regulation or final order – shown by Reports of Examination, cease and desist orders, and similar or prior actions/reports
  - Recklessly engaging in unsafe and unsound practices - concept embraces "any action or lack of action which is contrary to generally accepted standards of prudent operation, the possible consequences of which … would be an abnormal risks of loss to the institution." Green County Bank v. FDIC, 92 F.3d 633, 636 (8th Cir. 1996).
  - Risk of loss to Bank must "be reasonably foreseeable." Kaplan v. OTS, 104 F.3d 417, 421 (D.C. Cir. 1997)

Recent Enforcement of Regulatory Activities

Part II – Action for Civil Monetary Penalties

- Effects of Misconduct
  - Requires proof of causation. Dodge, 744 F. 3d at 158. The financial loss to the bank must be "by reason" of the alleged misconduct. Id.
  - Pattern of misconduct – action repeated year after year notwithstanding express instruction by regulatory agencies to cease
  - Causes more than a minimal loss - requires proof IAP's actions caused either an actual loss or prospective loss. Proffet v. FDIC, 200 F.3d 855, 864 (D.C. Cir. 2000)
  - Pecuniary gain or other benefit – requires proof IAP received an "actual benefit" for the misconduct. Seidman v. Office of Thrift Supervision, 37 F.3d 911,938 3rd Cir. 1994).
- Culpability of IAP
  - Requires proof of personal dishonesty or willful or continuing disregard for the safety or soundness of the Bank. Dodge, 744 F.3d at 159-160.
  - Both the personal dishonesty and willful or continuous disregard elements require some showing of scienter. Id. At 160

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- Formal action typically preceded by letter from agency to the IAP
- Agency allows IAP to respond to letter and show why formal action should not be commenced and CMPs should not be assessed.
- Statute with specific mitigating factors that agency "shall" take into account before assessing a civil monetary penalty
  - Financial resources of IAPs
  - Gravity of violation
  - History of violations by IAP
  - Other matters "as justice requires"
- FFIEC Policy Statement with additional factors (1998 WL 280287 6/3/98)
- Formal action may be commenced prior to expiration of six-year period beginning on date IAP separates from service (resignation or failure of bank)

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- Majority of actions are resolved by consent orders
- Settlement negotiations occur after agency receives IAP's response to initial letter
- Tolling agreements will extend period of time within which agency has time to act
- Insurance may not be used to pay CMPs. 12 U.S.C. 1828(k)(6).

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- In the matter of John Harris (OCC Matter #2015-126)
  - Sr. V.P. & Market Mgr. Gibraltar Private Bank & Trust
  - No admissions or denials by Harris
  - OCC found that Harris failed to properly oversee the account of a customer later determined to be operating a Ponzi scheme and approved multiple overdrafts and uncollected balances for the customer. OCC also found Harris accept gifts (including a Rolex watch) from the customer.
  - Bank paid $15 million to customers who alleged that bank aided and abetted the customer's fraudulent conduct.
  - Order of Prohibition and $75,000 CMP

Hot Topics for Bank Officers and Directors

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- In the matter of Phillip D. Murphy (OCC Matter #2015-004)
  - Managing Director, Municipal Derivatives Products Desk, Bank of America, N.A.
  - No admissions or denials by Murphy
  - OCC found that Murphy "directly and actively" engaged in conduct to rig bids related to 12 municipal derivatives transactions.
  - Murphy personally profited from the transaction and caused bank to suffer both risk of loss and actual loss.
  - Order of Prohibition and $15,000 CMP

Hot Topics for Bank Officers and Directors

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- In the matter of Thomas A. Neely, Jr. (FRB Docket Nos. 14-020-E-I; 14-020-CMP-I)
  - E.V.P. and Business Services Credit Executive, Regions Bank
  - No admissions or denials by Neely
  - FRB found that Neely engaged in unsafe and unsound practices/breaches of fiduciary duties by reporting nonaccrual loans as accruing, performing loans, and by knowingly providing false information to bank examiners during 2009 exam.
  - Neely's misconduct involved personal dishonesty and resulted in loss to Regions.
  - Order of Prohibition and $100,000 CMP

Hot Topics for Bank Officers and Directors

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- In the matter of Higher One, Inc. (FRB Docket Nos. 15-026-E-I; 15-026-CMP-I)
  - IAP of Customers Bank through a Deposit Processing Service Agreement
  - Provided assistance to colleges/universities in connection with disbursement of financial aid on deposit at Bank
  - Higher One website and marketing materials contained misrepresentations regarding cost of services and account features and limitations.
  - Higher One earned income from fees paid by students and from interchange fees paid by merchants accepting debit card transactions.
  - 850,000 total accounts; 570,000 assessed fees with inadequate disclosures.
  - $24,000,000 in restitution and $2,231,250 CMP

Hot Topics for Bank Officers and Directors

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- In the matter of Annie D. Taylor (FDIC Docket No. 15-0154k)
  - IAP of Farmers State Bank
  - No admissions or denials by Taylor
  - Taylor engaged in violations of law, recklessly engaged in unsafe or unsound practices, or committed breaches of her fiduciary duties.
  - Violations, practices or breaches constituted a pattern of misconduct or caused more than a minimal loss to the Bank.
  - FDIC considered "appropriateness of penalty with respect to financial resources and good faith of Taylor, the gravity of the misconduct, the history of Taylor's previous conduct, and such other matters as justice requires."
  - $35,000 CMP

Hot Topics for Bank Officers and Directors

Recent Enforcement and Regulatory Activities

Part II – Actions for Civil Monetary Penalties

- In the matter of Salvatore DiBenedetto (FDIC Docket Nos. 14-0095e; 14-0096k; 14-0158b; Enforcement Decision February 17, 2015)
  - IAP of Arcola Homestead Savings Bank
  - DiBenedetto established and maintained an "informal relationship" with Bank whereby he "procured and underwrote single family residential loans" through an affiliated business.
  - Bank funded loans "without further review, underwriting or approval."
  - DiBenedetto misappropriated funds rather than disbursing loan proceeds to borrowers.
  - Bank forced to write-off loans, thus sustaining losses of approximately $583,836.
  - Order of Prohibition, $626,789 in restitution to FDIC as Receiver, $205,000 CMP

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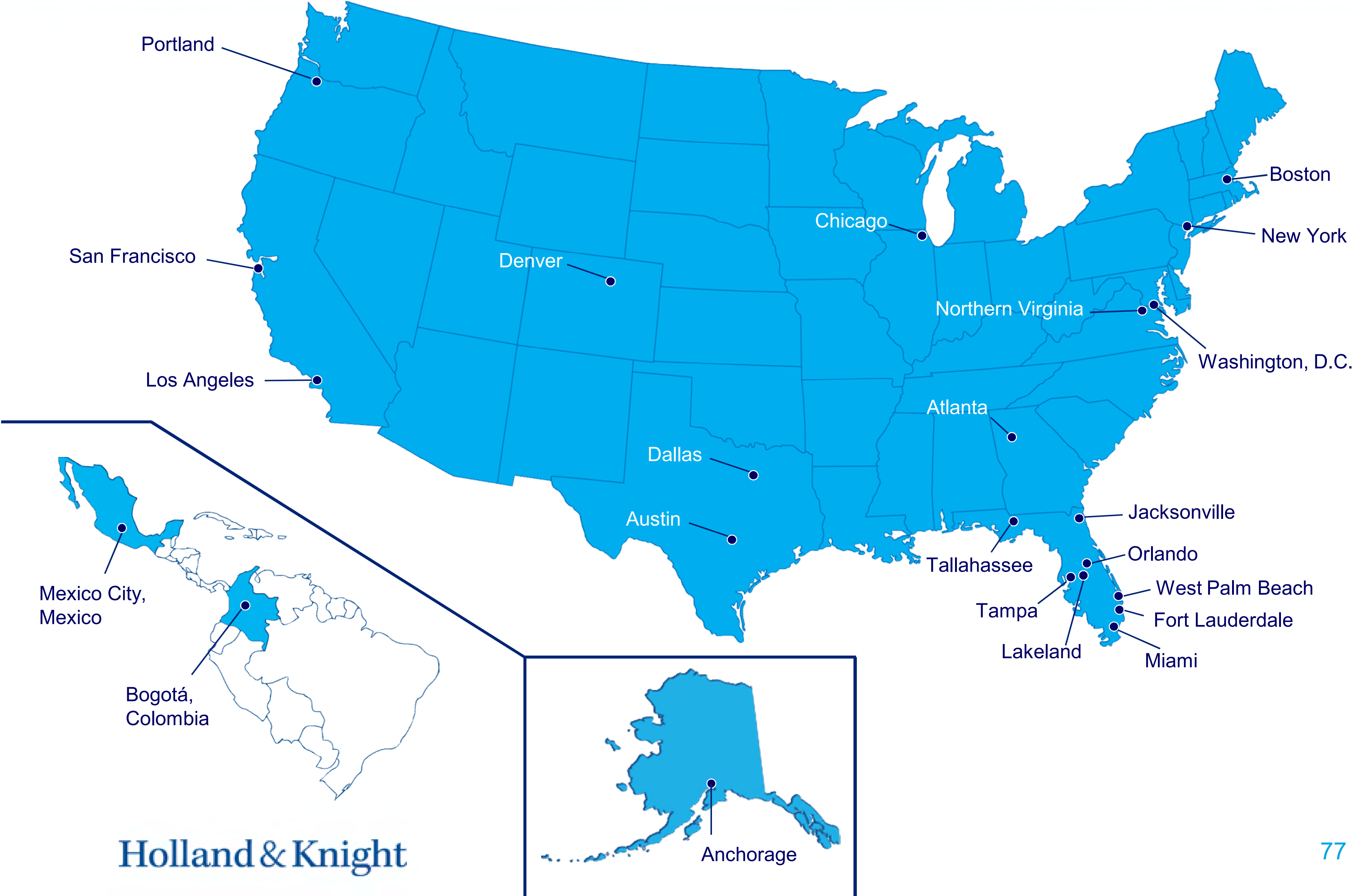

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Please join us for our next conference, “Basel III Capital Retention Requirements: Impact on Loan Structures and Loan Documentation - Structuring Yield Protection and Increased Costs Provisions, Transfer Restrictions, Purpose Clauses, HVCRE Loans, and More,” scheduled on Thursday, January 21, 2016 at 1pm EST.

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