

AABD SURVEY RESULTS

**MEASURING BANK DIRECTOR FEAR OF PERSONAL
LIABILITY**

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Over the past five years, AABD has received numerous reports from members of AABD that they and their fellow bank board members had heightened concerns about personal liability and, in some instances, one or more of their directors had resigned. Sometimes director candidates advised bank boards that they would not serve because of fear of personal liability.

In response to these reports, AABD initiated a survey designed to measure the impact of bank director concerns about personal liability on decisions by bank board members to resign and by others who turn down board seats.

AABD canvassed more than 2,000 banks and savings institutions – randomly selected – to measure the impact on banks and savings institutions of bank directors’ and prospective directors’ fear of personal liability. The questionnaire is found in Appendix I.

The following summarizes the results:

- Eighty banks responded to the questionnaire.
- Nineteen or 24.5% reported that within the past five years, they either had at least one director resign from office out of fear of personal liability; had at least one person offered a position as a director refuse to serve out of fear of personal liability; and/or had a director refuse to serve on the Board Loan Committee out of fear of personal liability.
- Of those who declined an offer to serve as a bank director (19 bank respondents), 47.3% (nine of the bank respondents) gave personal liability concerns as a reason.
- Nine banks or 11.3% reported that at least one director resigned because of fear of personal liability.
- Nine banks or 11.3% reported that at least one person offered a position as a director refused to accept the position from fear of personal liability.
- Nine of the banks that had Director Loan Committees or 11.5% reported that one or more directors refused to serve or to continue to serve on the Board Loan Committee out of fear of personal liability.
- Six of the banks or 8.7% reported that one or more directors resigned at least in part because of time commitments required in their role as a bank director.
- Fear of personal liability was the first most common reason given for refusing to accept bank director positions.
- Time commitments were the second most common reason given for refusal to accept bank director positions.

The fact that in just shy of 25% of the respondent banks have lost directors, have been told “no” by director candidates or have lost members or potential members of their Board Loan Committees from fear of personal liability should be of concern to banks, banking regulators, and the US Congress. Not so long ago, service on the board of directors of a bank was considered a great honor and few, if any, would walk away from the opportunity to serve.

Based on meetings and conversations with AABD members and other bank directors, AABD believes that the fear of personal liability is based on a number of factors, largely driven by federal banking agency suits, enforcement actions, threats of enforcement actions in reports of examination, and responsibilities placed on bank directors by laws, regulations and guidance that single out bank directors. In some instances, the inability of a bank to obtain sufficient director and officer insurance may also be a factor that exacerbates the fear.

During and after a deep recession such as that experienced several years ago, the threat of personal liability becomes more pronounced for bank directors. It begins to dawn on bank directors that no matter how financially strong their institutions may be, no bank is immune to the vagaries of the economy or to the possibility of a failure. With more bank failures comes greater potential personal liability.

This survey did not attempt to measure to what extent fear of personal liability may motivate bank boards to disapprove loans to creditworthy individuals and entities or to forego a business opportunity for their banks that the boards believe are prudent and sound. It also did not measure the extent to which the fear of personal liability may have motivated bank boards to be more prudent and avoid losses for their institutions.

The following are some of the factors that AABD believes contribute to the fear of personal liability that motivates bank director resignations and others to reject offers to serve as bank directors. It is within the power of the federal banking agencies and/or Congress to eliminate many of them.

Numerous suits filed by the FDIC against directors of failed banks.

As of the date of this report, the FDIC has sued former directors of failed banks in ninety suits since 2008 (and authorized suits involving 135 banks), or approximately 27% of the banks that failed since 2008. The statute of limitations has not run on a number of failed banks, meaning that the FDIC is likely to sue more.

The heart of these suits – virtually all of them against former directors of community banks – is the approval by the board or board committee of a handful of large loans that caused losses contributing to the bank’s failure, many in reliance on the recommendations of the loan and/or credit officers of the bank. Many of the suits single out directors who served on the Board Loan Committee.

AABD believes that the FDIC is treating these directors as if they are experienced loan or credit officers and not nonprofessional outside bank directors whose professions and businesses are, for the most part, in nonbanking industries and who are entitled to rely reasonably on the representations and recommendations made by their loan and credit officers. Directors who acted in good faith should not be sued.

FDIC suits grounded in simple, not gross negligence

Despite the FDIC’s policy of not approving suits against directors of failed banks unless it has determined that they committed gross negligence, the FDIC’s complaints often assert simple negligence, even in states which, in the view of AABD, have adopted a gross negligence standard.

A simple negligence standard is atypical of the standard applicable to corporate boards in most states, and in a case being reviewed currently by the Georgia Supreme Court, the FDIC is asserting that bank boards, unlike other corporate boards, are subject to a simple negligence standard.

According to the Georgia Department of Banking and Finance, this has a chilling effect on the willingness of bank directors to serve. AABD agrees, and is also concerned that the FDIC suits based on simple negligence will have a chilling effect on the decision-making process of those who continue to serve as bank directors. Bank board members may become too restrictive (and may have already become too restrictive) in how their bank makes loans to those in their communities.

Always being blamed for bank failures

Invariably, the Inspectors General of the FDIC, Fed and Treasury, in their Material Loss Reviews, point the finger at bank boards for having caused their banks to fail. See AABD Report on Material Loss Reviews dated January 29, 2013. Bank directors now know that if their bank fails, they will be blamed, regardless of the facts and circumstances.

Outdated FDIC policy on bank director responsibilities

The FDIC bases its decision whether to sue directors on an old and outdated policy statement that ignores the right of bank directors to rely reasonably on the work and opinions of bank management and advisors and that applies a simple negligence standard even though most states apply a gross negligence standard.

Bank directors overburdened by regulatory excesses

AABD's Bank Director Regulatory Burden Report identifies more than 800 provisions in law, regulation and regulatory guidance imposing some form of obligation on a bank director or board of directors. Directors are increasingly coming to the conclusion that their position is a no-win one.

Enforcement authority that allows imposition of liability without culpability

For several decades, the federal banking agencies have had the authority to impose civil money penalties on directors without having to prove that the directors did anything wrong. All it takes is that the Bank violate a law or regulation or engage in an unsafe or unsound banking practice and the director "participate" in the violation or practice, whether knowingly or unknowingly. The director can meet his or her fiduciary duties but that would not matter.

Over the past six years, directors have seen a huge uptick in enforcement actions against banks and insiders, including directors. They are feeling more vulnerable, for good reason. The Reports of Examination routinely warn boards of directors that they are susceptible to civil money penalties for the slightest infraction.

Demands by examiners for the net worth of bank directors

AABD has received reports that during examinations, bank examiners will require directors to provide them their net worth or recent tax returns, even if they are not borrowers from their bank. This is a highly offensive request that violates basic principles of privacy and can only intimidate directors for no reason.

Restrictions on bank directors' right to preserve records for legal defense purposes and defend themselves for official actions

In 2012, the FDIC issued a financial institution letter that suggests that bank directors are not entitled to access to bank records for the purpose of defending their official actions as directors. The agencies also sometimes bar bank directors in receipt of a 15-day letter or notice of other enforcement action from having their attorneys have access to reports of examination that are necessary to defend the action.

Limitations on directors insuring against risk of civil money penalties

After the FDIC adopted a rule in 1993 barring banks from paying premiums for insurance to cover civil money penalties imposed on bank directors, a number of carriers offered an endorsement to banks' D&O insurance that would allow directors to pay the premium directly to the carrier for such insurance. The FDIC did not object to that practice until only two years ago, concluding that so long as the coverage was part of the bank D&O policy, it was prohibited by the rule even though the directors paid for the insurance.

Difficulty obtaining D&O insurance to cover regulatory risks

As a result of the FDIC's aggressive suits against bank directors and officers over the past few years, the insurance carriers have refused to cover regulatory risks for an increasing number of banks.

Barring insurance that would cover costs defending directors against agency administrative actions

The FDIC's 1993 rule referred to above also bars insurance from covering defense costs incurred by bank directors in an agency enforcement proceeding if the director ultimately loses the case or if the case is settled. The directors may be covered, depending on the policy, for defense costs prior to formal notices being issued by the agencies, but once the notice is served, the directors run the substantial risk that they will either lose or settle the case, which happens in most enforcement proceedings. This FDIC rule makes it exceedingly difficult for bank directors to defend themselves against an enforcement action through the administrative process, thus depriving them of due process protections afforded to them in law.

Forcing restitution through administrative means

In 2005, AABD issued a report questioning the appropriateness of the federal banking agencies to force a director or officer to make restitution through administrative means rather than through a court of law. This is another potential threat to bank directors and remains a concern of AABD and its members.

Authority to use deep pocket subpoenas to obtain personal financial statements and tax returns

The FDIC has the authority and has used that authority to subpoena personal financial statements from former directors of failed banks without first going to a court of law to prove that the need to review the financial statements was justified. Private parties that are considering law suits don't have that authority.

Founded in 1989, the non-profit [American Association of Bank Directors](#) is the only trade group in the United States solely devoted to bank directors and their information, education, and advocacy needs. AABD recently established the Bank Director Liability Resource Center, which acts as a clearinghouse for developments in bank director liability, including lawsuits by FDIC against directors of failed banks and savings institutions. Recent books and reports published by AABD include “Bank Director Regulatory Burden Report”, “Bank Director Standards of Care and Protections: A Fifty-State Survey: “FDIC Director Suits – Lessons Learned”; and “Material Loss Reviews of Failed Banks: Are Bank Failures Really Always the Fault of Bank Directors?” The [Institute for Bank Director Education](#), established in 1993 as the educational arm of AABD, acts as a clearinghouse for education programs designed for bank and savings institution directors that support the nationally recognized [Director Certification Program](#). Visit AABD online at: <http://www.aabd.org>.