COUNSELOR'S CORNER

Preparing for the New Wave of FDIC Suits Against Bank Directors and Officers

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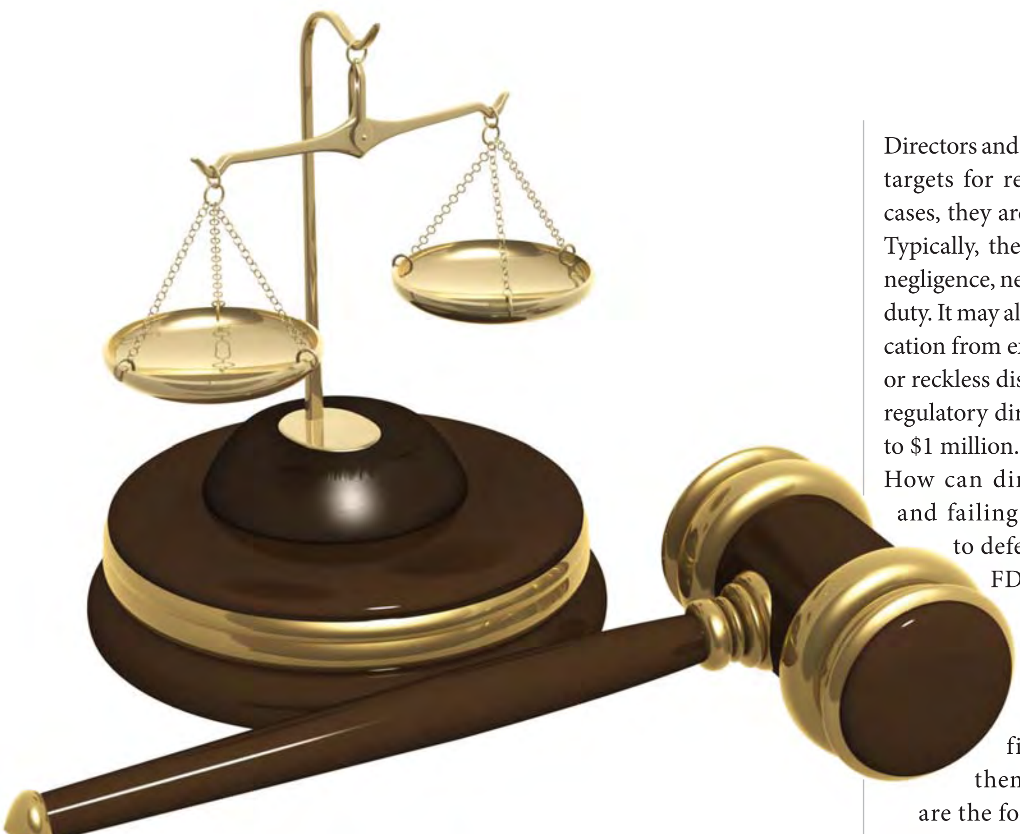

In the wake of the greatest financial crisis since the Great Depression, it is not surprising that directors and officers of financial institutions find themselves under intense scrutiny.

The Federal Deposit Insurance Corporation ("FDIC") recently announced that it has authorized suits against at least 187 executives of the more than 356 banks that have been closed by regulators since January 1, 2008. Currently, there are over 884 banks on the FDIC's watch list, and losses to the Deposit Insurance Fund are projected to reach $45 billion for the period June 30, 2009, through 2013.

Directors and officers are the most likely FDIC targets for recovery claims since, in many cases, they are covered by "D&O" insurance. Typically, the FDIC asserts claims for gross negligence, negligence and breach of fiduciary duty. It may also seek restitution or indemnification from executives for unjust enrichment or reckless disregard of any law, regulation or regulatory directive, and civil penalties of up to $1 million.

How can directors and officers of failed and failing lending institutions prepare to defend themselves for the day the FDIC comes calling?

Among the steps bank directors, officers and their counsel should take now before the first signs of trouble to defend themselves from possible claims are the following:

1. **D&O Insurance.** Directors and officers should review their D&O insurance with the bank's broker to determine whether there is adequate coverage for defending and settling potential FDIC and related litigation. Policy limits should be at least $10 million (preferably more) to cover attorneys' fees and other defense costs. Of particular concern are standard exclusions for fraudulent, intentional and criminal misconduct, as well as

the "regulatory" and "insured v. insured" exclusions, which may preclude coverage for claims by the FDIC or other regulators/receivers. Once the bank has become "troubled," it may be too late or cost prohibitive to place coverage, increase limits, or negotiate with the D&O insurer to minimize or remove these exclusions and other provisions that limit coverage.

2. **Articles of Incorporation and Bylaws**. The bank's articles of incorporation and bylaws should be reviewed to determine whether its directors and officers have the broadest indemnification rights legally available for advancement of defense costs and payment of any settlements and judgments in FDIC or other litigation. In addition, Washington banks' articles of incorporation can eliminate the personal liability of directors (but not officers) to the bank or its shareholders, and thus potentially to the FDIC as receiver, for money damages for breach of the directors' duty of care, unless a director (i) did not act in good faith, (ii) engaged in intentional misconduct or a knowing violation of law, or (iii) approved or received an unlawful distribution by the bank.

3. **Fiduciary Duties and the Business Judgment Rule**. Directors and officers must discharge their duty of loyalty by acting in good faith in a manner they reasonably believe to be in the bank's best interests, and may not act primarily for a non-bank purpose or put their personal interests ahead of the bank's. They must also fulfill their duty of care and ensure that the bank is operating in accordance with regulators' safety and soundness guidelines. This means that they must (i) monitor the bank's operations and inform themselves of all reasonably available material information, including "red flags" of existing or potential problems in bank actions and in reports provided by management or regulators; (ii) carefully consider that information and all reasonable alternatives; and (iii) act with the requisite care, including formulating, implementing and monitoring appropriate policies to clearly guide the bank's operations. Directors and officers may rely on professional advisors who have been reasonably selected and are acting within their area of expertise. However, they must still ask questions and evaluate the information they receive, establish and follow an appropriate decision-making process and maintain good records, such as Board minutes and reports, to show their compliance with the duty of care. The "business judgment rule" protects directors and officers in their decision-making process by creating a presumption that they acted on an informed basis, in good faith, and with the honest belief that they did so in the bank's best interests. Nevertheless, this protection for their decisions may be lost if there is evidence of self-dealing or improper interest, lack of good faith, fraud, recklessness, failure to act reasonably or exercise reasonable judgment, or abdication of their responsibilities.

4. **Preserving Documents and Information.** Directors and officers should inform themselves of the particular issues confronting the bank through a review of internal reports, examination and third-party reports, and other documents available while the bank remains open. Board minutes, resolutions and reports; loan committee minutes and loan files; underwriting and other policies, remedial and other action plans; and other bank documents and business records are critical evidence in defending bank directors and officers against FDIC allegations and proving that their actions met the required standard of care, but these records may be subject to confidential treatment or restricted access under state or federal law. Directors and officers should consult with their counsel about maintaining their access to and preserving such documents and information while avoiding any allegation that they improperly obtained or removed records and information from the bank.

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