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Regulators' New Focus on Director and Officer Liability Insurance; Other Considerations

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The Federal Deposit Insurance Corporation (the "***FDIC***") issued an advisory statement on October 10, 2013, titled "Director and Officer Liability Insurance – Policies, Exclusions, and Indemnification for Civil Money Penalties."

The advisory statement recommends that directors be well-informed about Directors & Officers ("***D&O***") insurance and also be mindful of whether the policy contains "regulatory exclusions." Although this is good advice in general, it is also self-serving for the FDIC. If an institution is closed by the FDIC, the existence of a regulatory exclusion cuts off one source of recovery for the FDIC and thus limits the ability of the FDIC to recover funds from the bank's directors and officers post-resolution.

The "regulatory exclusions" troubling the FDIC are provisions in some policies that automatically cancel coverage upon the closure of a financial institution. Other regulatory exclusion provisions in policies limit the exposure an insurer has in connection with any regulatory enforcement action a banking agency may take. These limitations take many different forms, but the basic concept is that coverage for directors and officers of a financial institution is limited or eliminated with respect to any matter involving regulatory action.

The advisory statement also provides as follows with respect to civil money penalties and institution affiliated parties ("***IAP***"—directors are included within those deemed to be IAPs):

> *In obtaining D&O insurance, the board of directors should also keep in mind that FDIC regulations prohibit an insured depository institution or depository institution holding company from purchasing insurance that would be used to pay or reimburse an institution-affiliated party (IAP) for the cost of any civil money penalty (CMP) assessed against such person in an administrative proceeding or civil action commenced by any federal banking agency…. The regulations do not include an exception for cases in which the IAP reimburses the depository institution for the designated cost of the CMP coverage.*

It is the FDIC's position that neither a bank nor a bank holding company can purchase civil money penalty insurance for its directors and other IAPs under 12 U.S.C. §1828 and 12 C.F.R. §359 (that portion of the Federal Deposit Insurance Act and the accompanying regulation promulgated by the FDIC governing golden parachute and indemnification payments by banks and bank holding companies). This prohibition applies whether or not the IAP reimburses the bank or holding company for the cost of the coverage.

But that prohibition on insurance for civil money penalties is not the whole of the story. While under the FDIC's regulation the IAP may not be indemnified for the actual civil money penalties imposed by a regulator, the financial institution *may* purchase insurance to indemnify of an IAP for the legal or other professional *expenses incurred in connection with defending* a proceeding in which the regulator considers imposing civil money penalties. This means that the financial institution may provide for the legal defense of its IAPs, but should civil money penalties be imposed, the IAPs will be required to bear the burden of payment of those penalties.

The regulatory exclusion is just one example of the need to carefully consider the entire policy or bond when reviewing insurance and bond coverage for a financial institution. These agreements are complex. The insuring clauses establish the basic framework for the coverages, but various riders or endorsements to the policy can substantially alter the nature (and

cost) of the protection provided. Other aspects of a policy that must carefully be considered are the definitions and the limitations on coverage, both of which typically are in separate sections from the insuring clauses.

With respect to D&O policies, there is no such thing as a standard form—each insurer provides to its insureds its own uniquely drafted policy. Fidelity bonds (sometimes referred to as bankers blanket bonds) often follow a form provided by the Surety & Fidelity Association of America (most use some version of Standard Form No. 24); but different versions of Form No. 24 exist, and not all bond providers use that form. As such, *careful* attention needs to be paid to both D&O policies and bonds in ensure that the financial institution is actually receiving the coverage it believes it has bought. It is not unusual for an insurer to amend its policies (through a rider or endorsement) to change the coverage to match the insured's expectations.

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