The Banking Law Journal

Established 1889

An A.S. Pratt™ PUBLICATION

JANUARY 2021

EDITOR'S NOTE: AVOIDING BANK FAILURES
Steven A. Meyerowitz

A POSSIBLE NEW BANK CRISIS – RESPONDING TO BANK CAPITAL DIRECTIVES AND RELATED ENFORCEMENT ACTIONS
Joseph T. Lynyak III

REVISING THE BANK MERGER GUIDELINES – PART I
David S. Neill, Damian G. Didden, and Christina C. Ma

BANKS HAVE MUCH AT RISK IN BATTLE OVER POWERS OF ATTORNEY IN NEW YORK
Michael J. Heller

FEDERAL AGENCIES PROVIDE GUIDANCE ON BSA/AML ENFORCEMENT AND DUE DILIGENCE REQUIREMENTS
Jessica S. Carey, Roberto J. Gonzalez, and Jacobus J. Schutte

LexisNexis

THE BANKING LAW JOURNAL

VOLUME 138 NUMBER 1 January 2021

Editor's Note: Avoiding Bank Failures
Steven A. Meyerowitz 1

A Possible New Bank Crisis—Responding to Bank Capital Directives and Related Enforcement Actions
Joseph T. Lynyak III 3

Revising the Bank Merger Guidelines—Part I
David S. Neill, Damian G. Didden, and Christina C. Ma 25

Banks Have Much at Risk in Battle Over Powers of Attorney in New York
Michael J. Heller 51

Federal Agencies Provide Guidance on BSA/AML Enforcement and Due Diligence Requirements
Jessica S. Carey, Roberto J. Gonzalez, and Jacobus J. Schutte 57

LexisNexis

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:
Matthew T. Burke at .... (800) 252-9257
Email: .... matthew.t.burke@lexisnexis.com
Outside the United States and Canada, please call .... (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:
Customer Services Department at .... (800) 833-9844
Outside the United States and Canada, please call .... (518) 487-3385
Fax Number .... (800) 828-8341
Customer Service Website .... http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or .... (800) 223-1940
Outside the United States and Canada, please call .... (937) 247-0293

ISBN: 978-0-7698-7878-2 (print)
ISSN: 0005-5506 (Print)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2021 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved.

No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

(2021–Pub.4815)

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF
STEVEN A. MEYEROWITZ
President, Meyerowitz Communications Inc.

EDITOR
VICTORIA PRUSSEN SPEARS
Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS
BARKLEY CLARK
Partner, Stinson Leonard Street LLP

CARLETON GOSS
Counsel, Hunton Andrews Kurth LLP

MICHAEL J. HELLER
Partner, Rivkin Radler LLP

SATISH M. KINI
Partner, Debevoise & Plimpton LLP

DOUGLAS LANDY
Partner, Milbank, Tweed, Hadley & McCloy LLP

PAUL L. LEE
Of Counsel, Debevoise & Plimpton LLP

TIMOTHY D. NAEGELE
Partner, Timothy D. Naegele & Associates

STEPHEN J. NEWMAN
Partner, Stroock & Stroock & Lavan LLP

THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. Copyright 2021 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

A Possible New Bank Crisis—Responding to Bank Capital Directives and Related Enforcement Actions

Joseph T. Lynyak III*

The COVID-19 pandemic has raised the possibility that the U.S. banking system will once again be faced with a series of potential bank failures due to credit defaults and concomitant bank capital deterioration. This article analyzes the process of bank insolvencies based upon credit defaults, including the use of new approaches that likely will be employed by the Federal Deposit Insurance Corporation and other bank regulators. It is intended to be a starting point for an organized approach to address bank capital inadequacy—and hopefully avoid bank failures.

As a result of the economic crisis arising out of the COVID-19 pandemic, in the next several quarters banking institutions are expected to experience increased loan defaults and accompanying deterioration in asset valuation, which may result in the Bank Regulators[1] taking aggressive action to prevent bank[2] failures by demanding significantly increased levels of capital, loan loss reserves and improved risk management. This regulatory reaction is typically implemented through the issuance of an enforcement order against the bank that contains: (a) a capital directive that raises a bank's capital level that exceeds the minimum capital level necessary to be deemed a "well-capitalized" institution; (b) a prompt corrective action order that limits the range of a bank's discretionary functions; and (c) a multitude of regulatory improvements intended to improve the ability of bank management and a board of directors

---

* Joseph T. Lynyak III, a partner in the Washington, D.C., and Southern California offices of Dorsey & Whitney LLP, focuses his practice on the regulation and operation of financial service intermediaries. He may be contacted at lynyak.joseph@dorsey.com. The author wishes to thank Thomas Kelly, Kevin Funnell, Jeffrey Tisdale, Thomas Scanlon, and Erin Bryan for their review and contributions to this article.

[1] The term "Bank Regulators" includes the Federal Deposit Insurance Corporation (the "FDIC"), the Office of the Comptroller of the Currency (the "OCC") and the Board of Governors of the Federal Reserve System (the "FRB"). While the emphasis in this analysis will be on the regulatory actions and responsibilities of the federal Bank Regulators, many of the same considerations (and enforcement authorities) will apply to the regulatory oversight and safety and soundness responsibilities of comparable state banking agencies.

[2] In this article the term "bank" will refer to an FDIC-insured depository institution, including state and national banks, savings associations and industrial loan companies.

to perform their management and oversight functions. Accompanying these directives is a designation that the bank is a "troubled" institution.[3]

Unfortunately, the combination of these regulatory actions has the effect of immediately imposing operational restrictions that, as a practical matter, impede a bank's ability to raise capital and restore operational stability.

Unlike the bank failures occurring during the 2007 to 2010 financial crisis, which was principally caused by a global liquidity crisis, the next round of bank failures may be caused by credit defaults that range from large corporations to "Main Street" businesses. Even though the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")[4] adopted numerous enhanced bank resolution authorities for the FDIC and other Bank Regulators, the process by which bank capital deterioration will be resolved remains based upon existing FDIC authority in place prior to the adoption of the Dodd-Frank Act.

Because memories have faded regarding bank insolvencies based upon credit defaults, this article reexamines that process, including the use of new approaches that likely will be employed by the FDIC and other Bank Regulators.[5] Specifically, this analysis will discuss from a practical perspective the issues presented to management and a board of directors of a bank and its holding company when the bank has been issued a capital directive and a prompt correction action ("PCA") order, defined below (collectively, "capital-related orders"). Among other things, the analysis identifies the various fiduciary and other legal obligations faced by stakeholders in a troubled bank, including its holding company, the boards of directors and management. In addition, this analysis describes the closing process typically followed by the FDIC should a bank fail, the potential liability of a board of directors and management following a failure, as well as reasonable steps that should be considered to defend against potential claims frequently made against former officers and directors by the FDIC.

[3] Section 32 of the Federal Deposit Insurance Act (the "FDI Act"), 12 U.S.C. § 1811 *et seq.*, requires troubled institutions to provide the FDIC with 30-days' written notice prior to the appointment of any director or senior executive officer. As implemented by regulations issued by the Bank Regulators, a troubled institution is defined as one: (a) with a composite CAMELS rating of "4" or "5;" (b) subject to a formal enforcement action; or (c) informed in writing by the Bank Regulator that it is in troubled condition on the basis of the bank's most recent report of condition, report of examination, or other information available to the Bank Regulator. *See*, 12 C.F.R. § 303.101(c).

[4] Pub. L. 111-203 (2010).

[5] This article is an updated version of an analysis originally published in *The Banking Law Journal* in 2012.

THE ISSUANCE OF A CAPITAL DIRECTIVE, DESIGNATION AS A TROUBLED INSTITUTION AND OTHER ENFORCEMENT ORDERS

Current Enforcement Actions

Prior to the COVID-19 outbreak, the banking industry was exceptionally profitable, and almost all banks received good or adequate CAMELS ratings.[6] However, commencing at the end of the third quarter in 2020 and accelerating in 2021, significant concern has been expressed that many banks composite CAMELS ratings are likely to drop from a 1, 2 or 3 to a 4 or a 5. Should this occur, accompanying one or several reports of examination assigning adverse CAMELS ratings will likely be the issuance of one or a series of cease and desist ("C&D") orders, which will include a capital directive that require a targeted bank to restore its Tier 1 capital level to 12 percent or 13 percent of risk-adjusted assets, and a PCA order requiring the bank to restore its capital ratios to the "well-capitalized" category.[7]

A capital directive is the regulatory tool of choice employed by the Bank Regulators to order a bank to maintain a level of capital that is unique to that bank and reflects a level of capital deemed reasonable by the Bank Regulator, and is frequently accompanied by a C&D order.[8] Unlike other statutory enforcement authorities that *theoretically* permit a bank to contest the underlying enforcement decision, judicial precedent supports the view that a bank has no right to an administrative review of the determination to issue a capital directive, and that any subsequent judicial review is limited as well.[9]

A corollary authority to a capital directive is the issuance of a PCA order, and is the authority utilized by the Bank Regulators to exercise increasing degrees of

---

[6] The examination rating scheme utilized by the Bank Regulators utilizes the acronym "CAMELS," which stands for capital, assets, management, earnings, liquidity and sensitivity to risk. A Bank Regulator assigns a rating to each component of the CAMELS, as well as an overall composite rating, with a 1 constituting the highest or best rating and a 5 indicating the probable failure of the bank. https://www.fdic.gov/regulations/laws/federal/UFIR.pdf.

[7] *See*, 12 C.F.R § 3.10 *et seq.* (OCC); 12 C.F.R § 217 *et seq.* (FRB); and 12 C.F.R. § 324 *et seq.* (FDIC).

[8] 12 U.S.C. § 3907. *See*, The International Lending Supervision Act, Pub. L. 104-208 (1996).

[9] *FDIC v. Bank of Coushatta*, 930 F.2d 1122 (5th Cir. 1991); *cert denied*, 502 U.S. 857 (1991). The result of this grant of agency discretion has resulted in the Bank Regulators using capital directives with increased frequency. (Although by itself the issuance of a capital directive does not impose operational restrictions on a bank, the use of a capital directive in combination with a "PCA" order, defined below, exacerbates the difficulty of restoring a bank to capital adequacy because the level of capital currently required by a capital directive generally is well

control over a capital-deficient institution as its capital deteriorates, as well as to alert the board and management of a bank that urgent attention must be taken to avoid a failure scenario.[10] This is accomplished because the capital levels articulated in the PCA regulations impose significant limits on a bank's operational flexibility, as follows:

- *Well Capitalized*—A Bank Regulator may lower the PCA status of a well-capitalized bank to that of adequately capitalized and apply those restrictions applicable to an adequately capitalized bank. (No bank may ever make a capital distribution or pay management fees if the bank would be undercapitalized after making such distributions or paying such fees.)
- *Adequately Capitalized*—the Bank Regulator may impose any limitation that applies to an undercapitalized institution.
- *Undercapitalized*—(a) drafting of a capital restoration plan; (b) restricting payment of capital distributions and management fees; (c) asset growth restrictions; and (d) prior approval required for acquisitions, branching and new lines of business.
- *Substantially Undercapitalized*—(a) all of the above; and (b) restrictions on senior executive officer compensation.
- *Critically Undercapitalized*—(a) all of the above; (b) limiting or prohibiting payment on subordinated debt; (c) authorizing the appointment of a receiver or conservator upon failure to remedy critically undercapitalized status (plus any additional limitations that may be imposed by the FDIC if it is not the Bank Regulator issuing the PCA); (d) refraining from entering into any material transactions (other than in the ordinary course); (e) extending credit for highly leveraged transactions; (f) amending the bank's charter or bylaws (except to comply with applicable law); (g) modifying accounting procedures; (h) engaging in certain affiliated transactions; (i) paying excessive compensation; (j) increasing the rate payed on deposits in the market; and (k) making principal or interest payments on subordinated debt.[11]

---

above the minimum capital level required by a PCA order, thereby acting as a disincentive for investors to provide new capital to the bank.)

[10] Section 38 of the FDI Act. For a useful summary of the authorities provided to the Bank Regulators under PCA authority, *see*, https://www.occ.treas.gov/news-issuances/bulletins/2018/bulletin-2018-33.html.

[11] Pursuant to Sections 38(c)(3) and 38(h)(3)(A) of the FDI Act, within 90 days the FDIC must close a bank when the bank's tangible equity falls below two percent.

In addition to the foregoing, accompanying capital-related orders imposed as a bank's capital deteriorates are a host of related regulatory restrictions and limitations typically contained in a C&D order. The Bank Regulators possess extraordinarily broad authority to require remedial action for banks under Section 8 of the FDI Act.[12] Because the FDI Act provides numerous remedial alternatives to the Bank Regulators to cure a perceived regulatory problem, a C&D enforcement order frequently contains a multitude of remedial risk management and other requirements which in the aggregate diverts personnel and economic resources available to a bank to resolve its capital deficiency concern. These remedial actions include compliance plans and numerous special reporting requirements, such as:

- Reducing classified assets;
- Maintaining adequate allowances for loan and lease losses;
- Developing an asset/liability management plan;
- Retaining acceptable management;
- Correcting violations of law and eliminating unsafe and unsound practices;
- Reducing unsafe concentrations of credit;
- Developing a comprehensive loan policy;
- Developing an acceptable strategic plan;
- Developing an acceptable budget and profit plan;
- Reporting progress to the Bank Regulator on a quarterly or other periodic basis; and
- Similar corrective measures and reporting requirements.

In addition to the foregoing, other remedies available under the FDI Act's C&D authority include:

- Requiring reimbursement, restitution, indemnification or loss guarantees;
- The imposition of growth restrictions;
- Requiring asset sales or other dispositions of problem assets;
- Requiring the rescission of contracts; and
- Requiring the employment of qualified management.

---

[12] 12 U.S.C. § 1811 *et seq. See*, *The Banking Law Journal, Responding to Proposed Enforcement Actions by the Federal Banking Agencies* (January 2005).

Further, the general enforcement authority found in the FDI Act applicable to all of the Bank Regulators overlaps with specific remedial authority the Bank Regulators may individually possess under their separate enabling statutes (such as the National Banking Act or the Federal Reserve Act) or special purpose laws (such as the Sections 23A and 23B of the Federal Reserve Act or the Bank Secrecy Act).[13]

Ability of a Bank or Holding Company to Contest Capital-Related Orders

Although it is possible to contest the issuance of a PCA or C&D order, as a practical matter banks rarely challenge the issuance of such orders. This is because the Bank Regulators' enforcement alternatives are so expansive (and potentially, overwhelming) that banks do not elect to contest administratively the issuance of a package of capital-related orders. (As noted above, capital directives are a purely discretionary determination by the Bank Regulators and hence are generally viewed as being beyond administrative review.)[14]

The practical inability to contest the issuance of capital-related and C&D orders places great strain on stakeholders of a bank and its holding company. This is because the failure to comply with such orders exposes parties to those orders—including management and directors—to potentially significant civil money penalties for noncompliance.[15] Notwithstanding the potential personal exposure to liability, other tactical and strategic considerations militate against

[13] The net effect of the combination of a capital-related order with a C&D's remedial tasks may act as a further disincentive on the part of potential investors to provide capital because of the reluctance by the Bank Regulators to remove the C&D order until the remedial corrective measures are satisfactorily completed (and a sufficient amount of time has passed to verify that the remedial measures are effective).

[14] Section 309(a) of the Riegle Community Development and Regulatory Improvement Act of 1994 required each of the Bank Regulators to adopt an intra-agency review and appeal process for material supervisory determinations. However, while that process is available, excluded from review are enforcement actions elected to be taken by the Banking Regulators. The effect of the statutory exclusions makes the use of this appeals process ineffective to a bank when capital deterioration has occurred and a PCA order has been issued. *See*, https://www.fdic.gov/news/board/2020/2020-08-21-notational-fr-a.pdf.

[15] The Bank Regulators may assess civil money penalties against a bank and its holding company and their respective officers and directors for the failure to comply with an enforcement order. For basic violations (i.e., regardless of fault), as adjusted annually for inflation, the Bank Regulators may assess a penalty in the amount of $10,245 for each day an alleged violation continues; for reckless violations that result in harm to the institution, the maximum penalty rises to $51,222 a day per officer and director; and for violations that indicate criminal or quasi-criminal activity, violations carry a punitive penalty as high as $2,048,915 per day for each officer and director of the institution and the insured depository institution itself. *See*,

direct opposition to the issuance of such orders. Among other things, this is because the capital restoration process requires obtaining the cooperation of the Bank Regulators, and hence banks prefer to avoid contesting the issuance of capital-related orders and would rather display a cooperative attitude at this stage in the process.[16]

The Process of Restoring Capital Adequacy

Because state and federal corporate and securities laws require that a bank or holding company take all reasonable steps to prevent a failure, the issuance of capital-related orders imposes obligations on a board and management to resolve the capital deficiency as well as the related enforcement orders contained in a C&D.[17]

For purposes of this discussion, such remedial actions might be segmented into the following tasks: (a) restructuring and recapitalization initiatives; (b) financial oversight activity; and (c) implementation of regulatory and risk management compliance requirements.

Each of these remedial actions is discussed separately below.

Restructuring and Recapitalization Initiatives

A bank or its holding company must generally engage investment bankers or similar consultants to assist in restoring capital adequacy. Inherent in this process is the need to prepare detailed financial analyses of the bank's current operations, including asset valuations necessary for investors to determine whether providing new capital to the bank is supported by the available data. Options at this time include seeking new capital from the existing shareholder base, soliciting new capital from the market and identifying potential merger partners. Because the preparation of detailed financial information provided to third parties creates liability under the securities laws (i.e., material disclosure obligations), care must be exercised.

During this period of time, it is not unusual for potential investors to request the opportunity to conduct due diligence on some or all of the operations of a

---

https://www.federalregister.gov/documents/2020/01/14/2020-00217/notice-of-inflation-adjustments-for-civil-money-penalties.

[16] For example, because a capital plan is almost always required as a component of a PCA order, a bank cannot proceed with a proposed capital restoration plan until it receives the approval of its Bank Regulator—which requires a degree of cooperation.

[17] While beyond the scope of this article, fiduciary obligations generally require a board of directors of a bank and a holding company to take all possible steps to avoid insolvency by taking reasonable steps to solicit new capital. Further, the failure to demonstrate that a robust capital-raising process was undertaken could subsequently expose management and a board to shareholder suits to a claim of breach of fiduciary duty.

bank, which requires the execution of appropriate confidentiality agreements and similar protections. (When the market perceives a series of bank failures to be occurring, potential investors oftentimes utilize this opportunity to better understand a bank's asset base in order to succeed in obtaining the bank's assets should the bank be closed by the FDIC.)

In addition to the foregoing, the Bank Regulators may require constant updates and information regarding progress being made to resolve the bank's capital concerns.[18]

Financial Oversight Activity

While a bank is attempting to raise additional capital, close monitoring of its financial condition and records is necessary in order to address several concerns.

In the case of the ongoing operations of the bank, the financial statements of the bank must coincide with the financial condition as determined by the Bank Regulators. This means that loan workouts, loan loss reserves and similar financial matters must be carefully reviewed and properly reflected under GAAP (and under more stringent bank regulatory accounting rules) on a bank's financial statements, including Call Reports, in order to avoid regulatory criticism.

Similarly, the financial performance of a bank can adversely affect the status of its holding company, which then might be required to address disputes with disgruntled investors. For example, in capital-deficiency situations, a PCA order will often prohibit dividends to be paid by a bank to its parent holding company—which usually affects the payment of expected dividends, and may affect the payment of interest to investors in debt issued by the holding company.[19]

Implementation of Regulatory and Risk Management Compliance Requirements

Finally, a bank, its management and its board of directors will usually be required to respond to a host of remedial measures contained in a C&D

---

[18] For example, in the case of a deteriorating real estate market in which additional reserves are constantly required to be added to a bank's ALLL, the restructuring and recapitalization process may include a series of additional write-downs that make investors leery of further investment.

[19] Although the Dodd-Frank Act added Section 38A to the FDI Act to statutorily adopt the "source of strength" doctrine for holding companies and other entities controlling FDIC-insured institutions (e.g., industrial loan companies), it is unclear regarding the effectiveness of a capital directive directed at a holding company or other controlling entity to maintain capital at a bank experiencing capital deficiencies. In a typical structure, most or all of the holding company's capital may already be allocated to the bank subsidiary, or to other operating subsidiary businesses and not readily available for contribution to the bank.

remedial enforcement order, which diverts attention from capital-raising efforts. Significant expenses may be incurred to accomplish tasks that in a capital crisis may appear to be of secondary importance yet are given seemingly identical weight by the Bank Regulators.

These corrective measures can be numerous and complex in nature. Further, it is not unusual that a capital-related and C&D order requires that a special board of directors oversight committee be created to review all remedial measures and regularly report to the Bank Regulator regarding progress being made.

RECOMMENDED STEPS TO BE TAKEN BY A BANK AND/OR ITS HOLDING COMPANY

Although the issues confronted by a bank and a holding company are numerous, the following recommendations are highlighted because of their proven usefulness to avoid personal liability should a bank be unable to restore itself to capital adequacy.

Document the Reasonable Supervision of the Bank by the Board of Directors and Management While the Bank Remains Open

In the last two cycles of bank failures, bank officers and directors were often accused of breaches of duty following the occurrence of sudden and unanticipated adverse economic conditions and concomitant loan losses. When viewed in hindsight, claims made by the FDIC to recover for breaches of duty were frequently difficult to defend against, due in no small measure by the lack of evidence supporting prudent management in the official records of the bank.

To address this concern, a board and management might consider a third-party analysis of the effectiveness of board and management oversight and controls being employed to govern the operation of the bank and its affiliates. The focus of such an analysis would be to evaluate whether a board and management were complying with their respective standards of care, including the tools being employed to properly comply with risk management protocols and similar guidance issued by the Bank Regulators. The analysis should be updated periodically, to document steps taken and alert the board and management to new issues.

In circumstances in which the standard of care as evidenced by the bank's board of directors and management is reasonable, placing a report of this type into the official records of a bank can prove to be an effective prophylactic measure against future accusations by the FDIC. Moreover, in the instances in which the effectiveness of a board or the bank's management is found to possibly fall below a reasonable standard of care, taking steps to adopt

recommendations for improved oversight further may protect insiders from allegations of breaches of fiduciary duty.

Assemble a Team

As noted above, there are three separate components that need to be addressed by a bank and its holding company upon the receipt of capital-related orders, and the creation of a cohesive team is a critical factor in both achieving success as well as demonstrating that fiduciary and corporate obligations were complied with as part of the process.

Team members should include lawyers experienced in the representation of banks that have received capital-related orders, including dealing with the Bank Regulators. In addition, regional or national investment banking firms and other bank consultants are likely to be required.

It is also important to recognize that a bank's or a holding company's stakeholders may have different economic and legal positions that frequently require separate counsel. For example, a holding company may require legal counsel separate from attorneys providing advice to the bank itself, including advice such as:

- The possibility of bankruptcy;
- The obligation of the bank and/or the holding company to indemnify the bank's officers and directors;[20]
- Securities law claims, including claims filed by the holding company's common and preferred shareholders and holders of the holding company's debt; and
- Direct claims by the FDIC against the holding company, such as claims arising from capital maintenance agreements and other regulatory obligations.

Similarly, individual directors of the board of directors may also require their own counsel to provide legal advice regarding compliance with their fiduciary duties.

Review Corporate Law Formalities

As is frequently the case, the articles and bylaws of a bank or its holding company may not reflect current legal protections available to officers and directors, such as liberalized corporate law indemnification procedures that

[20] Care must be exercised to comply with the FDIC's restrictions on indemnification to insiders at a bank, as well as providing so-called "golden parachute" payments to employees of a troubled institution. *See*, Section 18(k) of the FDI Act; 12 C.F.R. § 359.

make it easier to pay defense costs to officers and directors who are targeted for breaches of fiduciary duty. Similarly, several states provide potentially valuable limits on liability for independent directors by authorizing standards of care that may be more beneficial than those that apply for a bank's officers.

It is therefore important to conduct a corporate review to determine whether these and similar protections might be available. In many cases, it may be necessary to amend (or restate) the articles of incorporation and bylaws to adopt these corporate protections. However, the Bank Regulators may object to the adoption of such measures as a bank becomes more likely to fail.[21]

Reflect All Compliance Efforts in Writing

While it is usual and typical to engage in numerous oral and "off-the-record" conversations with representatives of the Bank Regulators such as on-site examination staff, the law provides that only the official records of the bank or holding company are relevant should enforcement action be taken. Accordingly, a bank and its holding company should at all times record its reasonable efforts to respond to all regulatory orders, as well as investigations into all alternative means of resolving a capital deficiency. The existence of a written record will likely be beneficial if claims are brought against officers and directors. For example, if a holding company or bank board is forced to substantially dilute existing shareholders by agreeing to a change of control or a merger transaction, demonstrating the efforts of an investment banker retained to identify all possible sources of new capital may provide protection against subsequent lawsuits by the diluted shareholders.

Review the Bank's Record-Retention Policy

One of the most significant errors often made by a bank or a holding company is the failure to adopt a records policy that permits officers and directors to retain copies of materials that reflect the performance of their duties and compliance with their respective fiduciary obligations. For example, in practically every jurisdiction, board members as a matter of right may retain their own copies of board materials used by them to oversee the bank and management—whether in the form of paper copies or materials provided in electronic form.[22]

---

[21] As noted above, the Bank Regulators have the authority under PCA authority to prohibit a critically undercapitalized bank from amending its articles and bylaws, which may have the effect of preventing a bank from updating its primary corporate chartering documents to provide available protections to bank insiders.

[22] A bank's record retention policy should be comprehensive and describe in detail copies of bank records that may be retained by board members when performing their management

It should be noted that this area is a particularly sensitive one in the view of the FDIC, and appropriate legal advice is strongly recommended to create a records retention policy that balances the several legal perspectives.

Review D&O Insurance Coverage

It is critical to the welfare of both a bank's and a holding company's officers and directors that coverage under officer and director liability policies is available and clearly understood.[23] Further, at the earliest opportunity, efforts should be made to determine whether additional coverage is available. Importantly, federal law specifically permits insurers to omit coverage for regulatory enforcement actions—including claims made by the FDIC following a bank failure—obtaining this coverage (which often can be obtained for an additional premium) is a significant protection for board members and senior management.[24]

THE FAILING BANK SCENARIO

In regard to the resolution capability of the Bank Regulators, the Dodd-Frank Act built upon prior federal bank legislation over several decades to address perceived flaws in the financial system that ignored systemic risks to the U.S. financial services system. In particular, the increased resolution authorities contained in the Dodd-Frank Act reflected that the liquidity crisis of 2007 to 2010 was caused by entities primarily outside of the jurisdiction of the Banking Regulators and other federal financial regulatory agencies.

Accordingly, the Dodd-Frank Act adopted numerous new authorities to allow for the supervision and examination not only of banks and bank holding companies, but also an expanded range of financial entities outside of the traditional banking system. Provisions included, among others:

- The creation of the Financial Stability Oversight Council;

---

oversight. Further, care must be exercised to address electronic communications and the retention policies applicable to insiders.

[23] It is important to understand that the interpretation of coverage provided by directors and officers liability insurance is highly specialized and is not a matter of general contract law. In the minimum, it is very useful to engage legal counsel with experience in the complexities of managing the relationship between the insurer and the officers and directors covered under a liability policy. Among other things, the technical requirements of notice and coverage terms under a policy must be well understood and managed so as to avoid inadvertently losing the ability to make a claim should a claim be required, including a claim based upon either an enforcement action or a bank failure.

[24] Section 11(k) of the FDI Act.

- Enhanced prudential standards to apply to larger banks and holding companies, including stress testing and the preparation of living wills;
- Providing the FDIC with orderly liquidation authority to resolve not only banks but an entire bank holding company system for systemically important "SIFIs" and "G-SIBs");
- The regulation of the swaps and derivatives markets;
- The so-called Volcker Rule; and
- Increased capital requirements for SIFIs and G-SIBs.

The Bank Regulators, in conjunction with other federal and international financial regulators, implemented a multitude of new regulatory requirements over a five-year period, imposing on larger banks and holding companies substantially increased capital, reporting and compliance obligations.

While the prophylactic measures adopted by the Dodd-Frank Act have generally been viewed as salutary by creating a safer U.S. financial system, the basic authority of the FDIC to resolve bank failures has been unaffected. This is because that, with one exception, no U.S. bank failure has occurred involving a bank whose assets exceeded $60 billion, and hence the authorities contained in the FDI Act to close and resolve banks prior to the adoption of the Dodd-Frank Act have been more than adequate to address all bank failures to date.[25]

What follow, then, is an analysis of the process by which the FDIC closes a bank (i.e., other than a systemically significant SIFI or G-SIB requiring the use of the new authorities provided by the Dodd-Frank Act).

The FDIC's Bank Closing Process

Assuming that a bank failure cannot be avoided, the FDIC will schedule a proposed closing date—typically on a Friday afternoon—and coordinate under the various statutory provisions of the FDI Act and, if applicable, related state banking statutes to have itself appointed receiver of the bank.[26]

---

[25] https://www.fdic.gov/bank/historical/reshandbook/. While the Washington Mutual Bank failure involved bank assets exceeding $327 billion, the FDIC was paid a premium for that entity and incurred no loss. *See*, https://www.fdic.gov/Bank/individual/failed/wamu.html#:~:text=Possible%20Claims%20Against%20the%20Failed,Insurance%20Corporation%20was%20named%20receiver.&text=Washington%20Mutual%2C%20Inc.,-filed%20for%20bankruptcy.

[26] Although the actual language of the provisions of the FDI Act indicates that there is some discretion by the primary bank regulator not to appoint the FDIC as conservator or receiver of a failing bank, that language is formalistic in deferring to a determination regarding the appointment of a conservator or receiver; in fact, the FDIC possesses contrary statutory authority

Having determined that a failure cannot be avoided, the FDIC will evaluate and select the "least cost alternative" for resolving the potential bank failure as required by the FDI Act—which often means that a so-called "purchase and assumption" ("P&A") transaction will be utilized. Essentially, a P&A transaction is a sale and assumption of some or all of the assets and liabilities of a failed bank, with the assuming entity—usually another bank or holding company—immediately opening the failed bank on the next business day as a branch of the assuming bank or chartering the failed bank as a separate subsidiary of the holding company acquiring the failed bank.

In a P&A transaction, the FDIC as receiver will retain all assets not assumed by the successful bidder, and may share losses on a negotiated basis with the assuming bank or holding company, which in common parlance is referred to as a "loss share" agreement.[27] In addition, claims and other liabilities against the failed bank unrelated to assets transferred to the assuming entity will remain with the FDIC as receiver, including various litigation claims.[28] In this manner, the receivership is able to "wash" the assets and liabilities of the failed institution through the receivership, thereby transferring the "good" assets to the purchaser and retaining in the receivership all adverse claims relating to transferred assets or liabilities.[29]

The FDI Act provides authority for the FDIC to affirm or repudiate a wide range of unsecured contractual obligations between a failed bank and counterparties, with repudiated contract claims becoming a claim against the bank receivership, including contracts for the purchase, sale and lease of real and

---

under the FDI Act to appoint itself cause as receiver should a primary bank regulator ever make an election to the contrary.

[27] During the bank failures commencing in 2007 through 2010, the use of loss share agreements were the prevalent form of P&A transaction employed by the FDIC. *See*, https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/lossshare/banklist-lossshare.html. Among other things, the use of loss share agreements substantially eliminated the need for the FDIC to employ the same number of liquidation specialists as compared to the formidable bureaucracy created by the Resolution Trust Corporation during the savings and loan crisis. *See*, https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum10/sisummer10-article1.pdf.

[28] The powers and authorities of the FDIC as receiver are formidable and generally are viewed as exceeding the powers exercisable by a bankruptcy trustee. *See* Section 1821 *et seq.* of the FDI Act.

[29] Section 11(d)(11) of the FDI Act (d)(11) is the so-called "deposit preference" provision that establishes a waterfall of priorities for claims made against a bank receivership. Under the statue, deposit claims (most of which are usually held by the FDIC) have priority over other unsecured claims. *See*, https://www.fdic.gov/bank/analytical/banking/9910.pdf.

personal property assets and service contracts.[30] However, the FDI Act limits the FDIC's receivership authority for a broad category of financial instruments termed "qualified financial contracts" or "QFCs," and specifically permits counterparties to enforce rights under those instruments, as well as limiting the FDIC to a narrow range of remedies, including the transfer of a QFC to a third party.[31] (The FDI Act provides for a claims process whereby stakeholders objecting to their treatment by the receivership may file objections and have those claims administratively considered.)

To effectuate a P&A transaction—as well as to minimize the cost of a failure to the FDIC's Deposit Insurance Fund—the FDIC will develop a bid package in the weeks leading up to a bank failure and invite interested parties to bid on the failing bank. Qualified bidders—which usually include direct competitors of the failing bank—may be afforded the opportunity to perform some degree of on-site and/or offsite due diligence, and to submit competitive bids that permit the respective qualified bidders to specify the terms for a proposed P&A transaction, including the degree to which the FDIC would be required to provide financial assistance, including asset support and other types of indemnification.[32]

Following the conclusion of the bidding process—which typically is completed by the middle of the week in which the bank closing is scheduled—upon receipt of official notification that the bank has been closed and that the FDIC has been appointed as receiver, the FDIC and the successful bidder enter the closed bank and take control of the operations of the failed institution. Although an exhaustive discussion of the FDIC's closing procedures is beyond the scope of this analysis, closing procedures generally include:

- Assuming both legal ownership and physical control of all components of the failed bank's assets, liabilities and operations;
- Closing out all deposit and lending transactions as of the day of the

---

[30] Section 11(e)(1) of the FDI Act. Among other things, the FDIC may affirm performance under service contracts, but repudiate at a later date. Section 11(e)(7)(C) of the FDI Act.

[31] A QFC includes a securities, commodities or forward contract, repurchase agreement, swap agreement and related agreements defined by the FDIC by regulation. 12 U.S.C. § 1821(e)(8) of the FDI Act.

[32] During the bank failures in 2007 through 2010 significant interest was expressed by private equity funds and other non-bank investors (utilizing complex investment structures) in acquiring failed institutions. Following criticism allowing this category of investors to participate in the resolution process, the FDIC adopted a policy for qualifying investment groups that effectively foreclosed this source of new bank capital. *See*, https://www.fdic.gov/regulations/laws/federal/2009/09FinalSOP92.pdf.

closing;

- Inventorying physical assets;
- Creating a closing balance sheet that will become the basis for the P&A transaction; and
- Other receivership functions.[33]

Finally, the FDIC executes the P&A agreement with the successful bidder and commences the process of transferring the operations of the failed bank to the new owner.

Contesting a Bank Closing

Although there are instances in which the closing of a bank may be viewed by stakeholders as unfair or perhaps illegal, there are no modern instances in which a bank closing has been reversed or enjoined. This is because the FDIC's bank closing process reflects a public policy that critically undercapitalized banks should be resolved as quickly as possible to minimize losses to the Deposit Insurance Fund.

Accordingly, notwithstanding any perceived unfairness of the situation, there is no reliable modern precedent for stakeholders convincing a court to halt or to reverse a bank failure. Rather, it is more useful for officers and directors to focus on the goal of preventing a failure from actually taking place by restoring capital adequacy, and thereby in avoiding personal liability if the bank ultimately fails. Stated another way, the only reasonable course of action upon the receipt of capital-related orders is to devote all resources and best efforts to restoring the bank to capital adequacy in a manner that is satisfactory to the Bank Regulators (and to demonstrate that such efforts are being made).

CLAIMS MADE AGAINST FORMER OFFICERS AND DIRECTORS BY THE FDIC FOLLOWING A BANK FAILURE

In its role as receiver of a failed bank, the FDIC's authority under the FDI Act authorizes it to stand in the shoes of the bank, the bank's former shareholders and its officers and directors. Because the FDIC—as the operator of the Deposit Insurance Fund—has a fiduciary duty to minimize its losses as a result of a bank failure, it regularly initiates an investigation into the reasons for the failure. Specifically, for larger bank failures the FDIC's inspector general

[33] Detailed descriptions of numerous tasks performed by the FDIC immediately prior to a bank closing, during the weekend immediately following, and thereafter are set forth in the FDIC Receivership Manuals and related interpretative guidance. *See*, https://www.fdic.gov/bank/historical/reshandbook.

conducts an investigation to determine whether grounds exist to allege misfeasance or malfeasance against insiders at the failed bank, as well as other persons or entities involved in the management of the bank such as independent (i.e., outside) directors.[34] In the case of a bank holding company, the FDIC may make claims against the holding company for the failure of the holding company to support the capital needs of the failed bank, as well as to claim ownership of assets such as tax-related net operating losses.[35]

The post-closing period can be very difficult for former bank insiders because the FDIC possesses investigative authority that includes subpoena authority to depose former officers and directors, as well as to require insiders to disgorge records and documents that are owned by the bank and which are not records personally maintained by the particular officer or director.[36]

The Investigation of a Failure by the FDIC

The single most important change that occurs following a bank failure is that the former officers and directors no longer constitute management and the board, but rather, become the targets of investigation by the FDIC. This is because the FDIC as insurer and the receiver of a failed bank or thrift is statutorily required to investigate why the failure occurred. (Moreover, as noted above, the FDIC in its role as the receiver of the failed institution has a fiduciary duty to the Deposit Insurance Fund and to the depositors and other creditors of the failed institution to recover assets to minimize losses.)[37]

The FDIC's investigative process following a bank failure typically has three stages. The first occurs as of the date of closing and immediately thereafter and includes taking control of all property and documents belonging to the failed bank, including bank records and other materials that address the potential liability of directors and management. Following a short period of time that involves on-site inquiries, the FDIC next conducts a forensic investigation regarding losses at the failed bank, which may take several years. At the conclusion of that analysis, staff at the FDIC and its local counsel evaluate all

---

[34] Section 38(k) of the FDI Act. A "material loss review" analyses a loss to the FDIC after-the-fact and includes a requirement of determining whether the loss could have been prevented. (This analytical approach has been criticized by commentators as acting as a disincentive for FDIC staff to exercise discretion favoring a bank experiencing capital issues as the bank seeks to recover.)

[35] The FDIC has successfully litigated lawsuits over these tax issues. *See*, https://www.supremecourt.gov/DocketPDF/18/18-1269/94891/20190401124403768_No.%2018-__%20Cert%20Petition%20Appendix%20-%20Rodriguez%20v.%20FDIC.pdf.

[36] Section 11(d)(2) of the FDI Act.

[37] Section 11(k) of the FDI Act.

data that has been assembled, and tentatively identify individuals to target who are associated with the failed institution—which almost invariably includes some or all senior officers and directors of the failed bank.[38]

Finally, the FDIC sends to individuals who have been targeted a demand letter that notifies them that the FDIC may hold them liable for the failure, and includes an extensive list of theories of liability—which essentially are alternative formulations of breaches of the standard of care owed by the targeted individuals. Generally accompanying the demand letter is an investigative subpoena that requests documents related to the failed institution, as well as detailed personal financial information of the targeted officer or director.[39] If necessary, the FDIC may elect to take depositions to gather additional information, including making inquiries of deponents regarding individual loan transactions and other matters that might support the FDIC's liability analysis.

At the conclusion of this process, the FDIC considers the evidence it has obtained and determines whether to initiate litigation against targeted individuals or attempt to settle alleged claims based upon available funds, such as an officer's and director's liability policy. Targeted individuals are always notified of the FDIC's decision to sue prior to the filing of the complaint, and are typically provided an opportunity to negotiate a settlement of the case.[40]

The Standard of Liability Required for Officers and Directors to Be Found Liable for Damages

While the FDIC conducts its investigations on a national basis, it is important to note that with respect to state-chartered institutions, the FDIC is bound by state law standards of liability as a result of an important Supreme Court decision. In the case of *Atherton v. FDIC*,[41] the FDIC alleged that it was entitled to a national standard of liability when recovering against officers and directors of failed institutions. Specifically, the FDIC claimed that a provision that was included in the FDI Act set a national standard of simple negligence.[42]

---

[38] A particularly difficult decision is often presented to targeted officers and directors to waive an applicable statute of limitations while the FDIC completes its analysis whether to make claims against targeted insiders. *See*, Section 11(d)((14) of the FDI Act.

[39] Sections 8(n) and 10(c) of the FDI Act.

[40] While the amount claimed by the FDIC as its loss is usually staggering in the amount claimed by an FDIC receivership, claims are usually settled for a much lesser amount. It should also be noted that the FDIC engages in an economic analysis to determine whether alleged claims should be pursued based upon the likelihood that assets would be available to pay a judgment or settlement.

[41] 519 U.S. 213 (1997).

[42] Approximately 40 state jurisdictions have adopted gross negligence as the standard of

The Supreme Court disagreed, and determined that state law controlled the establishment of the duties owed by officers and directors of state-chartered banking institutions, subject to a significant qualification. Specifically, the Court interpreted Section 11(k) of the FDI Act as setting gross negligence as the minimum ceiling for liability with each state being empowered to set a stricter standard such as mere negligence. Stated another way, the Court recognized a partial preemption of state law by which state law could set a liability level that was higher than the federal standard (i.e., mere negligence), but the federal standard would trump a state law standard should the local standard exceed gross negligence.

Following *Atherton*, numerous states adopted special rules establishing liability limitations for officers and directors—and in the majority of states those standards require a showing of gross negligence or intentional conduct.[43] In regard to national banks, the OCC has permitted national banks to adopt corporate governance provisions under several alternative state laws, which impliedly include the chosen standard of care adopted by that state for corporate officers and directors.[44] Accordingly, in order to establish liability, the FDIC must conform to the state law duty owed by officers and directors to a state-chartered institution, as well as the standard for judging whether a breach of that duty creates liability for the members of the board or management.[45]

Steps to Be Taken Following a Bank Failure

Although prudent action remedial taken when a bank remains open is the most effective way to protect officers and directors (and mitigate potential liability) following a failure, several items are noteworthy, as follows:

Holding Company Concerns

Following a bank failure, the solvency of the holding company becomes an issue, and a bankruptcy frequently follows (particularly for single-asset holding

---

liability that is required to be shown in order to recover from officers and directors. (Several states differentiate between officers and directors by applying a gross negligence standard to outside directors and a negligence standard to inside directors and officers.)

[43] However, as noted above, under *Atherton* the standard of care may not be less than gross negligence for banks.

[44] 12 C.F.R § 7.2000. A national bank may adopt the corporate law of: (a) the state in which the main office of the national bank is located; (b) the law of the state in which the bank holding company is incorporated; (c) the Delaware Corporate Code; or (d) the Model Business Corporation Act.

[45] Among other things, state law also determines the nomenclature to be used for applying any duties and standards that are created. For example, many states employ, the "business judgment rule" as a means to evaluate conduct.

companies). Because a holding company is not generally subject to the special bank receivership rules governing a failed bank subsidiary, the holding company must consider securities law claims, including claims filed by the holding company's shareholders, as well as direct claims by the FDIC against the holding company, such as claims arising from capital maintenance agreements and similar regulatory obligations.[46]

Liability Insurance Coverage

During the period in which a bank's capital deteriorates, a bank must place the insurer on notice of potential FDIC claims, and that the insurer accepts coverage—or at least issues a reservation of rights notice that permits the payment of defense costs. (This is because under many state insurance laws the failure to strictly comply with notification claims may void coverage.) Further, former directors and management must also understand the role of the insurer in the FDIC investigative process. For example, it is necessary to distinguish between policies that require an insurer to provide a defense (which places the insurer in the position to actively participate in defending claims brought by the FDIC), versus a duty to pay defense costs that obligates an insurer to reimburse for legal costs (but counsel is retained directly by the targeted officers and directors). Similarly, it is important that the rights of the insurer be understood when participating in settlement negotiations with the FDIC, including the ability of the insurer to directly engage the FDIC in discussions.[47]

Investigative Subpoenas

The FDIC typically issues investigative subpoenas that are directed at targeted officers and directors.[48] These subpoenas are extraordinarily broad in scope, and seek records held by the recipient, as well as detailed financial records of the individual. It should be noted that these subpoenas are not self-enforcing, which means that to enforce the subpoena in regard to a subpoenaed party's objections, the FDIC is required to seek enforcement by a federal district court.

---

[46] It should be noted that Title II of the Dodd-Frank Act provides authority to the FDIC to resolve not only a large bank (e.g., a SIFI or a G-SIF) but the entire holding company enterprise as well. While a subject of immense interest to academics, the reality is that the FDIC has never been required to resolve a SIFI or a G-SIF utilizing the "orderly liquidation authority" or "OLA" pursuant to Title II of the Dodd-Frank Act, and its capability to do so is at best theoretical. (However, while the OLA will continue to remain theoretical, the "living wills" provision of the Dodd-Frank Act and implementing regulations by the FDIC and the FRB have provided useful insight into the complexity of large holding company structures, and may prove useful should a large bank resolution be required.)

[47] For example, in instances in which director and officer liability insurance is available, liability insurers frequently make settlement negotiations with the FDIC a three-party negotiation.

[48] Section 11(d)(2)(I) of the FDI Act.

The task of complying with an investigative subpoena requires care to ensure that the FDIC is not allowed to engage in a fishing expedition in order to identify deep pockets that justify proceeding with litigation. However, if settlement negotiations appear to be advisable, the FDIC will generally insist that some financial information be provided by the targeted individual prior to settlement discussions taking place. Should a strategic decision be made that some financial information will be provided, care must be exercised so that inadvertent misstatements are not included in any financial disclosures—particularly since federal criminal laws apply to false statements made to the FDIC.[49]

Transfers of Assets by Officers and Directors

The FDI Act contains a very punitive provision that the FDIC views as authorizing it to avoid transfers of assets held by former officers and directors of a failed institution that are viewed as not being arms-length. Because the FDIC conducts an investigation that includes identifying asset transfers through the use of public records, caution and sensitivity to this issue when electing to engage in personal financial planning by targeted individuals is warranted.[50]

Assembling Bank-Related Documents

Following a failure, if officers and directors do not have personal copies of documents used in the performance of their duties, a high priority should be placed on assembling appropriate documentation. As noted above, immediately after a failure, the FDIC will prohibit officers and directors from having access to documents necessary to respond to (and defending against) charges that might be brought against them.

Accordingly, it is very useful if counsel representing individual officers and directors obtains copies of bank records pertinent to the performance of management's and a board's responsibilities during the time the bank remains open and operating. Copies' of records that may prove to be valuable include:

- Board packets and minutes;

[49] It should be noted that FDIC subpoenas requesting bank documents also include electronic communications such as emails, which means that personal computers used by outside directors must be accessed and emails and documents provided to the FDIC for bank-related materials. The permissibility of bank insiders, including board members, to conduct official bank business on private computer equipment should be addressed in a bank's records policy. (The assistance of forensic computer experts experienced in retrieving emails is recommended for this task.)

[50] Section 11(d)(17) of the FDI Act.

- Loan committee minutes;
- Regulatory correspondence and compliance records;
- Copies of pertinent liability policies; and
- Formal and informal communications with state and federal banking regulators.[51]

It should be emphasized that the retention of records is deemed a highly sensitive issue by the FDIC, and it is strongly recommended that experienced counsel be consulted in regard to bank-related records. For example, while the FDIC takes the legal position that most bank documents concerning customers' personal financial information cannot be retained by former officers and directors, the FDIC has been reasonable in negotiating the use and retention of bank records that directly impact the potential liability of targeted individuals.

* * *

The COVID-19 pandemic has raised the possibility that the U.S. banking system will once again be faced with a series of potential bank failures due to credit defaults and concomitant bank capital deterioration.

The foregoing discussion and analysis is intended to be a starting point for an organized approach to address bank capital inadequacy—and hopefully avoid bank failures.

Prior experience has demonstrated that prudent steps taken as soon as a bank's capital deteriorates not only maximizes the ability of a bank's management and board of directors to restore a bank to capital adequacy, but also minimizes the risk that allegations may be brought by the FDIC and the other Bank Regulators based upon of breaches of fiduciary duty owed to the bank.

---

[51] Because the FDIC succeeds to the rights of a bank in regard to its agents and representatives, the FDIC has traditionally taken the position that, following a bank failure, bank records held by the bank's regular outside counsel are now subject to control by the FDIC—and the former outside counsel may directed to treat the FDIC as the client and former insiders in an adversarial manner.