



UNC  
SCHOOL OF LAW

NORTH CAROLINA  
BANKING INSTITUTE

---

Volume 19 | Issue 1

Article 6

---

3-1-2015

# Bank Directors Beware: Post-Crisis Bank Director Liability

Emily S. May

Follow this and additional works at: <http://scholarship.law.unc.edu/nbi>



Part of the [Banking and Finance Law Commons](#)

---

## Recommended Citation

Emily S. May, *Bank Directors Beware: Post-Crisis Bank Director Liability*, 19 N.C. BANKING INST. 31 (2015).

Available at: <http://scholarship.law.unc.edu/nbi/vol19/iss1/6>

This Note is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Banking Institute by an authorized editor of Carolina Law Scholarship Repository. For more information, please contact [law\\_repository@unc.edu](mailto:law_repository@unc.edu).

---

---

# Bank Directors Beware: Post-Crisis Bank Director Liability

## I. INTRODUCTION

The average corporation in twenty-first century America is becoming startlingly similar to an eighteenth century European pirate crew. Described by one historian as “sea-going stock compan[ies],” pirate ships featured elected captains and officers.<sup>1</sup> Despite pop-culture depictions of pirate captains as tyrannical, monstrous figures with hook hands and a suspiciously large cut of the plundered booty, these captains and officers in fact often served entirely at the pleasure of their pirate crews.<sup>2</sup> The pirate captains were often held liable and penalized for poor judgment, behavior that the crew felt did not serve its interests, or, in Captain Charles Vane’s case, plain old-fashioned cowardice.<sup>3</sup>

Today, corporations, including banks, are becoming much more like these pirates’ sea-going stock companies by increasingly holding members of their boards of directors personally liable.<sup>4</sup> Although holding bank directors liable for decisions made in their official capacity does not result in the same penalties that pirate captains received, the punishment of personal liability has been increasingly used by the Federal Deposit Insurance Corporation (“FDIC”) in the past few decades and since the 2008 financial crisis in particular.<sup>5</sup>

This Note examines the most recent wave of personal liability for bank directors regarding decisions made in their official capacity, as well as the implications that this trend may have on bank directors and shareholders. Part II discusses FDIC claims against bank directors, including the FDIC claim process, the applicable law, and the standard

---

1. Peter T. Leeson, *An-aargh-chy: The Law and Economics of Pirate Organization*, 115 U. CHI. J. POL. ECON. 1049, 1064–67 (2007).

2. *Id.*

3. *Id.*

4. See FED. DEPOSIT INS. CORP., PROFESSIONAL LIABILITY LAWSUITS 1 (2014) (stating that between January 1, 2009, and December 19, 2014, the FDIC has authorized suits “against 1181 individuals for D&O liability,” including “104 filed D&O lawsuits . . . naming 793 former directors and officers”).

5. *Id.*

of care in director liability cases.<sup>6</sup> Part III details the trend prior to the 2008 financial crisis in bank director personal liability in enforcement actions.<sup>7</sup> Part IV examines the post-2008 financial crisis trend in bank director personal liability in enforcement actions and details the characteristics of many post-crisis claims.<sup>8</sup> Part V discusses methods that banks use to protect their directors from personal liability, including indemnification agreements and director and officer liability insurance policies (“D&O insurance”).<sup>9</sup> Part VI addresses the potential effects of holding directors personally liable, both from the directors’ and shareholders’ perspectives.<sup>10</sup> Finally, Part VII concludes by considering the overall impact of director personal liability and discussing a potential alternative to holding directors personally liable.<sup>11</sup>

## II. FDIC CLAIMS AGAINST BANK DIRECTORS

When a federally insured bank fails, the FDIC is appointed as receiver by the bank’s regulator, which is determined by the bank’s charter.<sup>12</sup> The FDIC also covers the losses resulting from the bank’s collapse in order to limit risks to the deposit insurance fund and the effect of the bank’s failure on the financial system.<sup>13</sup> As receiver, the FDIC conducts investigations into the bank’s failure and, if necessary and prudent, brings professional liability suits against the failed bank’s former directors and officers on behalf of the bank itself.<sup>14</sup> The FDIC can hold directors personally liable for gross negligence or conduct that exceeds gross negligence,<sup>15</sup> and therefore, a bank director is required to act as a “prudent and diligent business person.”<sup>16</sup> While gross

---

6. *See infra* Part II.

7. *See infra* Part III.

8. *See infra* Part IV.

9. *See infra* Part V.

10. *See infra* Part VI.

11. *See infra* Part VII.

12. FED. DEPOSIT INS. CORP., RESOLUTIONS HANDBOOK, ch. 7 (2003).

13. *Id.*

14. ANJALI C. DAS, WILSON ELSEER MOSKOWITZ EDELMAN & DICKER LLP, CLIENT ALERT: NEW FDIC LAWSUITS ATTACK FORMER BANK D&Os 2 (May 2011), *available at* [http://www.wilsonelser.com/writable/files/Legal\\_Analysis/ins\\_fdic\\_may11.pdf](http://www.wilsonelser.com/writable/files/Legal_Analysis/ins_fdic_may11.pdf).

15. Federal Deposit Insurance Act (FDIA), 12 U.S.C.A. § 1821(k) (West 2013).

16. *See* FED. DEPOSIT INS. CORP., FIL-87-92, STATEMENT CONCERNING THE RESPONSIBILITIES OF BANK DIRECTORS AND OFFICERS (1992), *available at* <https://www.fdic.gov/regulations/laws/rules/5000-3300.html>.

negligence is the stated standard of care, in practice, many FDIC professional liability suits bring claims under a lower standard of simple negligence.<sup>17</sup> The most common claims brought by the FDIC against directors of failed banks allege the following: “(i) dishonest conduct or abusive insider transactions; (ii) violations of internal policies, law, or regulations that resulted in a safety or soundness violation; or (iii) failure to establish, monitor, or follow proper underwriting procedures, or heed warnings from regulators or advisors.”<sup>18</sup>

A. *The FDIC Claim Process*

The first step in the FDIC receivership process is for the bank’s chartering authority to close the bank and to name the FDIC as the receiver.<sup>19</sup> The appointment of the FDIC as receiver of a bank is not mandatory, but may occur for a number of reasons, including a bank’s maintenance of insufficient assets for obligations or undercapitalization.<sup>20</sup> After the FDIC is named as the receiver, the FDIC leads an investigation into the financial institution.<sup>21</sup> If this investigation uncovers material that warrants an FDIC claim and any attempted settlements between the FDIC and the director fail, the potential claim goes to the FDIC’s Board of Directors (“FDIC Board”) for consideration.<sup>22</sup> If the FDIC Board decides to pursue action against the director or the financial institution, the FDIC will file a claim in federal court.<sup>23</sup>

Before filing the claim in court, the FDIC must first consider two questions in order to justify the suit: (1) whether success on the claim is more likely than not, and (2) whether pursuing the claim will be

---

17. *AABD Survey Result on Measuring Bank Director Fear of Personal Liability Are Not Good News*, AM. ASS’N OF BANK DIRECTORS (Apr. 9, 2014), <http://aabd.org/aabd-survey-results-measuring-bank-director-fear-personal-liability-good-news/>.

18. Mary C. Gill et al., *Claims Against Bank Directors and Officers Arising From the Financial Crisis*, 26 REV. BANKING & FIN. SERVICES 69, 70 (2010).

19. 12 U.S.C.A. § 1821(c)(5), (2)(A)(ii); DONNA L. WILSON & KRISTOPHER KNABE, BUCKLEY SANDLER LLP, *FDIC BANK FAILURE LITIGATION: UNDERSTANDING AND NAVIGATING THE FDIC’S PROFESSIONAL LIABILITY AND MORTGAGE FRAUD SUITS* 3–4 (Apr. 18, 2012).

20. WILSON & KNABE, *supra* note 19 (citing 12 U.S.C.A. § 1821(c)(5)).

21. FED. DEPOSIT INS. CORP., *supra* note 16, at 2 (referencing FDIA § 884, 12 U.S.C.A. § 1821).

22. *Id.* at 2.

23. *Id.*

cost effective.<sup>24</sup> In assessing the likelihood of success, the FDIC conducts a thorough interview of the factual circumstances surrounding the claim.<sup>25</sup> In assessing whether pursuing the claim is likely to be cost effective, the FDIC investigates potential recovery award assets, such as the bank's D&O insurance coverage and the director's personal assets.<sup>26</sup> The FDIC only pursues claims where the recovery is expected to justify the costs of investigation and litigation.<sup>27</sup> Therefore, D&O insurance is an important consideration since directors often do not have sufficient personal assets to cover FDIC claims.<sup>28</sup>

*B. Applicable Law and Standard of Care*

Before the savings and loan crisis ("S&L crisis") in the mid-1980s, the spotlight on bank and S&L directors' activities was not as blinding as it is today.<sup>29</sup> After many depository institutions failed during the S&L crisis, consumers and the market looked for answers and the FDIC focused more on directors.<sup>30</sup> To protect directors and officers from this new scrutiny, states passed statutes that raised the standard of care to gross negligence for bank director and officer personal liability.<sup>31</sup> Statutes like these, referred to as "insulating statutes," offer directors extra coverage by requiring that parties, including the FDIC, bringing action against them, prove a "disregard for a director's duties or an extreme deviation from expected behavior," as opposed to the previous, lower standard of ordinary negligence.<sup>32</sup>

---

<sup>24.</sup> *Id.*

<sup>25.</sup> *Id.*

<sup>26.</sup> DAS, *supra* note 14, at 2.

<sup>27.</sup> THOMAS P. VARTANIAN & ROBERT H. LEDIG, DECHERT LLP, BANK D&O DEFENSE MANUAL 6 (May 2012), available at [http://www.dechert.com/files/Publication/7f7fad0c-600b-4f85-8cab-461dc3e08b49/Presentation/PublicationAttachment/0f32f58c-b774-4c95-9c37-118103b6d303/Bank%20DO%20Defense%20Manual\\_May2012.pdf](http://www.dechert.com/files/Publication/7f7fad0c-600b-4f85-8cab-461dc3e08b49/Presentation/PublicationAttachment/0f32f58c-b774-4c95-9c37-118103b6d303/Bank%20DO%20Defense%20Manual_May2012.pdf).

<sup>28.</sup> FED. DEPOSIT INS. CORP., MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 271 (1998).

<sup>29.</sup> See generally Ronald W. Stevens, *FDIC Lawsuits Against Former Directors and Officers of Banks That Have Failed Since 2008: Is This Déjà Vu All Over Again?*, 97 Banking Rep. (BNA) No. 16, at 762 (Nov. 1, 2011).

<sup>30.</sup> *Id.*

<sup>31.</sup> *Id.*

<sup>32.</sup> Benjamin Saul, *Know the Standard of FDIC Liability for Community Banks Portfolio Media Inc.*, LAW360 (Feb. 5, 2013, 9:48 AM), <http://www.law360.com/articles/411958/know-the-standard-of-fdic-liability-for-community-banks>.

Delaware statutes demonstrate this protective approach, imposing only two basic fiduciary duties on directors and officers: the duty of care and the duty of loyalty.<sup>33</sup> The duty of care requires that directors execute their duties in good faith, with the same level of care that an ordinarily prudent director would use,<sup>34</sup> and “in a manner [the director] believes to be in the best interests of the corporation.”<sup>35</sup> Similarly, the duty of loyalty requires directors to act on behalf of the corporation,<sup>36</sup> and refrain from “self-dealing, usurpation of corporate opportunity, and any acts that would permit them to receive an improper personal benefit or injure their constituencies.”<sup>37</sup>

In 1989, Congress responded to these insulating statutes by passing the Financial Institutions Reform Recovery and Enforcement Act (“FIRREA”).<sup>38</sup> Included in FIRREA was the authorization for the FDIC to hold directors personally liable for gross negligence.<sup>39</sup> FIRREA preempts the insulating statutes in FDIC claims on behalf of state-chartered banks.<sup>40</sup> While there was disagreement over whether FIRREA’s new standard also applied to federally-chartered banks,<sup>41</sup> the Supreme Court ultimately resolved this disagreement in 1997, holding that state law dictates the applicable standard.<sup>42</sup> Therefore, FIRREA can only impose a lower bar for personal liability suits in FDIC claims on behalf of state-chartered banks.<sup>43</sup> As a result, the FDIC is permitted to pursue claims against directors of federally chartered banks even under simple negligence if state law allows it.<sup>44</sup>

While directors may face liability under either state law or the

---

33. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367–68 (Del. 1993).

34. *Id.*

35. Stevens, *supra* note 29 (quoting Calif. Corp. Code § 309(a)).

36. *Guth v. Loft*, 5 A.2d 503, 510 (Del. 1939).

37. LATHAM & WATKINS, FIDUCIARY DUTIES AND POTENTIAL LIABILITIES OF DIRECTORS AND OFFICERS OF FINANCIALLY DISTRESSED CORPORATIONS 2 (June 2003), available at <http://iiiglobal.org/component/jdownloads/finish/393/1422.html>.

38. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12 and 15 U.S.C.); VARTANIAN & LEDIG, *supra* note 27, at 5.

39. VARTANIAN & LEDIG, *supra* note 27, at 5 (referencing Federal Deposit Insurance Act (FDIA) § 884(k), 12 U.S.C.A. § 1821(k) (West 2013)).

40. See, e.g., *Fed. Deposit Ins. Corp. v. Canfield*, 967 F.2d 443 (10th Cir. 1992), *en banc*, *cert. denied*, 506 U.S. 993 (1992).

41. *FED. DEPOSIT INS. CORP.*, *supra* note 28, at 275.

42. *Atherton v. Fed. Deposit Ins. Corp.*, 519 U.S. 213, 227–28 (1997).

43. See *Atherton v. Fed. Deposit Ins. Corp.*, 519 U.S. 213, 227–28 (1997).

44. PROFESSIONAL LIABILITY LAWSUITS, *supra* note 4.

FIRREA standard, the common law business judgment rule<sup>45</sup> helps protect directors of both state and federally chartered banks who face FDIC claims.<sup>46</sup> The business judgment rule provides a presumption that absent any self-interest, directors making a business decision are acting in good faith and with due care.<sup>47</sup> The rule has often been used to shield directors against FDIC claims of negligence or breach of fiduciary duty.<sup>48</sup> Because it bestows a strong presumption of good faith and due care upon directors, even director decisions that have proven disastrous can be protected if the director reasonably believed it was in the corporation's best interest at the time.<sup>49</sup>

In *FDIC as Receiver for Cooperative Bank v. Willets*,<sup>50</sup> for example, the United States District Court for the Eastern District of North Carolina held that the business judgment rule completely protected a group of bank directors and officers that had been sued by the FDIC.<sup>51</sup> In 2006, Cooperative Bank ("Cooperative"), based in Wilmington, North Carolina, earned a CAMELS "2" rating, which indicates a fundamentally sound firm with only moderate weaknesses.<sup>52</sup> Cooperative was downgraded to a CAMELS "5" rating in 2008 and was closed in 2009.<sup>53</sup> After coming under FDIC receivership, the FDIC sued nine of Cooperative's directors and officers, alleging negligence, gross negligence, and breach of fiduciary duty regarding imprudent lending practices.<sup>54</sup> Stating that the business judgment rule defeated the FDIC's negligence and breach of fiduciary duty claims and that there was "no gross negligence on the part of Cooperative's directors and

---

45. EDWARD BRODSKY & M. ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES, AND LIABILITIES § 2:12 (2014).

46. VARTANIAN & LEDIG, *supra* note 27.

47. BRODSKY & ADAMSKI, *supra* note 45.

48. VARTANIAN & LEDIG, *supra* note 27, at 8.

49. *Id.*

50. Fed. Deposit Ins. Corp. v. Willets, No. 7:11-cv-00165-BO (E.D.N.C. Sept. 11, 2014), ECF No. 124; *see also* CAMDEN R. WEBB & KACEY L. HUNT, WILLIAMS MULLEN, CLIENT ALERT: FDIC v. WILLETS (Nov. 10, 2014).

51. WEBB & HUNT, *supra* note 50, at 5.

52. *Id.* at 2. Banks receive composite ratings known as "CAMELS," based on six factors: (1) capital adequacy; (2) asset quality; (3) management; (4) earnings; (5) liquidity; and (6) sensitivity to market risk. CAMELS ratings range from one, which represents "the strongest performance and risk management practices" to five, which signals a high level of concern regarding management practices and performance. COMPTROLLER OF THE CURRENCY, BANK SUPERVISION PROCESS 9 (2007).

53. WEBB & HUNT, *supra* note 50, at 5.

54. *Id.* at 3.

officers,” the court ultimately granted summary judgment in favor of the directors and officers.<sup>55</sup> The combination of the business judgment rule and adherence to Cooperative’s internal lending policies by directors and officers combined to create a strong presumption of innocence for the directors and officers.<sup>56</sup> Cooperative’s case signals the strong level of protection the business judgment rule can provide directors in an otherwise unforgiving post-crisis personal liability landscape.<sup>57</sup>

### III. PRE-CRISIS TREND IN REGULATION

Before the 1980s, bank director liability suits were not so common.<sup>58</sup> In fact, the FDIC initially had no receivership staff dedicated to professional liability issues.<sup>59</sup> Following the S&L crisis, however, FDIC and Resolution Trust Corporation<sup>60</sup> lawsuits against directors and officers increased.<sup>61</sup> Between the early 1980s and the mid-1990s, the FDIC filed more than 800 professional liability lawsuits after more than 1,600 FDIC-insured depository institutions failed.<sup>62</sup> Ultimately, between 1986 and 1996, the FDIC and RTC collected more than \$5 billion, with \$1.3 billion of that total coming from claims against directors and officers.<sup>63</sup> As a result of this increase in professional liability suits, the FDIC created a full-time receivership staff dedicated entirely to professional liability issues.<sup>64</sup>

Despite a late-1990s lull, the early 2000s brought an increase in the number of professional liability suits once again, this time as a result

---

55. *Id.* at 5.

56. *Id.*

57. *Id.*

58. FED. DEPOSIT INS. CORP., *supra* note 28, at 268.

59. *Id.*

60. The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 established the Resolution Trust Corporation (“RTC”) with the objectives of managing and resolving cases related to depository institutions and maximizing the value generated from the liquidation of depository institutions. Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 501(a), 103 Stat. 183, 363. The RTC was abolished in 1991, Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991, Pub. L. No. 102-233, § 310, 105 Stat. 1761, 1769, and its corporate functions were terminated pursuant to the Resolution Trust Corporation Completion Act, Pub. L. No. 103-204, 107 Stat. 2369, 2369 (1993).

61. *See generally* Stevens, *supra* note 29.

62. FED. DEPOSIT INS. CORP., *supra* note 28, at 270.

63. *Id.* at 285.

64. *Id.* at 268.

of accounting fraud scandals.<sup>65</sup> In the early 2000s, corporations and banks like Enron and Superior Bank, as well as their auditing firms such as Arthur Andersen and Ernst & Young, were accused of accounting fraud.<sup>66</sup> For example, after Superior Bank was closed and put into receivership by the FDIC in 2001, the Office of Thrift Supervision cited improper accounting, poor lending practices, and ineffective management supervision as contributing factors in the bank's failure.<sup>67</sup> The FDIC brought suit against Superior Bank's accounting firm, Ernst & Young, for \$2 billion.<sup>68</sup> Fearing a lawsuit against themselves as well, the bank's owners, the Pritzker family, settled with the FDIC for an immediate payment of \$100 million and an additional \$360 million over the subsequent fifteen years.<sup>69</sup> Accounting fraud scandals like this sparked an increase in professional liability suits in the early 2000s and renewed the fear of director liability.<sup>70</sup>

#### IV. CURRENT TREND IN REGULATIONS AND COMMON CHARACTERISTICS OF RECENT FDIC CLAIMS

By 2007, some suggested that the increased-liability wave that began after the accounting scandals of the early 2000s was fading away and an era of decreased personal liability for directors was finally returning.<sup>71</sup> The increased-liability atmosphere returned once again, however, at the beginning of the 2008 financial crisis,<sup>72</sup> with a spike in the number of FDIC professional liability lawsuits following a surge in bank failures.<sup>73</sup> In total, the FDIC has named 749 directors and officers

---

65. *Id.* at 271.

66. John McCormick, *Pritzker's Superior Bank Subprime Losses Blemish Resume*, BLOOMBERG (May 21, 2013), <http://www.bloomberg.com/news/2013-05-22/pritzker-s-superior-bank-subprime-losses-blemish-resume.html>.

67. *Id.*

68. David Moberg, *Breaking the Bank*, IN THESE TIMES (Nov. 8, 2002), <http://inthesetimes.com/issue/27/01/feature2.shtml>.

69. *Id.*

70. FED. DEPOSIT INS. CORP., *supra* note 28, at 271.

71. *Delaware Courts Again Are Safe Haven for D&Os*, ACE GROUP (Jan. 2007), <http://www.acegroup.com/bm-en/media-centre/delaware-courts-again-are-safe-haven-for-dos.aspx>.

72. Thomas P. Vartanian et al., *Enforcement Actions Continue Three-Year Decline; DOJ Emerges as Major Player*, 102 Banking Rep. (BNA) No. 20, at 947, 947-953 (May 20, 2014).

73. *Id.*

in ninety-seven lawsuits since 2009.<sup>74</sup> The aggregate settlements obtained not only from lawsuits pursued by the FDIC and RTC, but also from claims against directors and officers that did not result in a filed complaint, is approximately \$330 million.<sup>75</sup>

FDIC professional liability claims against former directors of failed banks since the 2008 financial crisis share common characteristics, including the named defendants, damages sought, and the amount that directors have paid out-of-pocket from judgments and settlements.<sup>76</sup> Although the number of bank failures per year has decreased since 2010, the number of professional liability suits against directors and officers peaked in 2013 at fifty-three.<sup>77</sup> This is likely due to the FDIC's statute of limitations on professional liability claims—three years for tort claims and six years for contract claims—which can be extended if state law permits a longer period of time.<sup>78</sup>

While a statute of limitations could hamper FDIC professional liability claims in some circumstances, the FDIC has an additional tool: “tolling agreements.”<sup>79</sup> Tolling agreements provide the FDIC an additional year after the expiration of the statute of limitations to determine whether it will file a lawsuit following a bank's failure.<sup>80</sup> Tolling agreements are often agreed to by potential defendants in order to allow more time for the parties to reach a pre-litigation settlement and avoid trial altogether.<sup>81</sup> As a result, these agreements are a valuable option for the FDIC because of the lengthy and costly nature of litigation.<sup>82</sup> The FDIC's authority to extend the statute of limitations arises out of the Federal Deposit Insurance Act, which allows the FDIC

---

74. WEBB & HUNT, *supra* note 50.

75. ABE CHERNIN ET AL., CORNERSTONE RESEARCH, CHARACTERISTICS OF FDIC LAWSUITS AGAINST DIRECTORS AND OFFICERS OF FAILED FINANCIAL INSTITUTIONS 2 (2013).

76. *See generally id.*

77. Vartanian et al., *supra* note 72, at 6.

78. PROFESSIONAL LIABILITY LAWSUITS, *supra* note 4, at 1; VARTANIAN & LEDIG, *supra* note 27, at 8.

79. Emily Atkin, *FDIC Amping Up Suits Against Failed Bank Execs*, LAW360 (Sept. 16, 2013, 8:33 PM), <http://www.law360.com/articles/473008/fdic-amping-up-suits-against-failed-bank-execs>.

80. *Id.*

81. OFFICES OF INSPECTOR GEN., OIG-CA-14-012, ENFORCEMENT ACTIONS AND PROFESSIONAL LIABILITY CLAIMS AGAINST INSTITUTION-AFFILIATED PARTIES AND INDIVIDUALS ASSOCIATED WITH FAILED INSTITUTIONS 30 (July 2014).

82. Susan N.K. Gummow, *Back to the Future: FDIC Litigation Has Returned*, RUTGERS BUS. L.REV. 1, 26 (2011).

to both extend running statutes of limitation as well as “revive an expired statute of limitations in select cases, including claims involving alleged fraud or intentional misconduct.”<sup>83</sup>

While professional liability claims since the 2008 financial crisis have been as high as \$600 million each, the majority of these claims have been for amounts less than \$20 million.<sup>84</sup> These claims are pursued in part to recoup any losses incurred by the FDIC deposit insurance fund when it stepped in to cover a failed bank’s obligations.<sup>85</sup> In aggregate, between 2007 and 2013, 471 bank failures in the United States have resulted in a \$92.5 billion hit to the FDIC’s deposit insurance fund.<sup>86</sup> In order to mitigate these losses, the FDIC prefers to reach settlements with banks and their directors, rather than pursue litigation against them.<sup>87</sup>

While the FDIC’s preference for settlement may save litigation costs, the secrecy surrounding these post-financial crisis settlements has received some criticism.<sup>88</sup> In what the Los Angeles Times described as “a major policy shift from previous crises, when the FDIC trumpeted punitive actions against banks as a deterrent to others,” FDIC settlement agreements have begun to include “no press release” clauses.<sup>89</sup> These clauses promise that the FDIC will not engage in publicity regarding the settlement terms.<sup>90</sup> Although the FDIC cannot legally keep details of its settlement amounts secret, these clauses allow directors to minimize damages and avoid admitting wrongdoing.<sup>91</sup> The “no press release” clauses also mean that the settlements are not “trumpeted” as they were following the S&L crisis.<sup>92</sup> Consequently, these settlements do not provide the deterrent force that may result from a publicized

---

83. Joshua Glazov, *When the FDIC Takes over a Failed Bank: Business Pitfalls and Opportunities*, MUCH SHELIST (May 12, 2010), <http://www.muchshelist.com/knowledge-center/article/business-pitfalls-and-opportunities-when-the-fdic-takes-over-a-failed-bank>.

84. CHERNIN ET AL., *supra* note 75, at 10.

85. E. Scott Reckard, *In Major Policy Shift, Scores of FDIC Settlements Go Unannounced*, L.A. TIMES (Mar. 11, 2013), <http://articles.latimes.com/2013/mar/11/business/la-fi-fdic-settlements-20130311>.

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

settlement.<sup>93</sup>

Although personal contributions by directors in these settlements are often negotiated away or covered by D&O insurance policies,<sup>94</sup> there is still a risk that directors may have to pay out-of-pocket.<sup>95</sup> Of the forty-four agreements involving directors and officers filed between January 2008 and April 2013, 39% required payments by directors and officers out of pocket, for an aggregate of \$8 million.<sup>96</sup> These personal contributions were often in addition to payments made by insurance providers,<sup>97</sup> as in the case of IndyMac and Washington Mutual.<sup>98</sup> One former IndyMac CEO's recent settlement with the FDIC was reportedly \$12 million, with \$1 million of that amount designated to come from the officer's personal funds, and the remaining \$11 million to be covered by D&O insurance.<sup>99</sup> In another settlement reached between the FDIC and three Washington Mutual officers, the officers were required to pay out-of-pocket a combined \$400,000 of the total \$64 million settlement agreement.<sup>100</sup> Although these examples detail settlements regarding officers, directors have experienced similar settlements.<sup>101</sup> In a 2012 settlement with the FDIC, Downey Financial Corporation's former board chairman and co-founder, Maurice McAlister, agreed to pay \$1.93 million out-of-pocket, with other Downey insiders agreeing to pay an additional combined \$1.75 million.<sup>102</sup> The bank's insurer paid an additional \$28.4 million.<sup>103</sup>

---

93. *Id.*

94. JOHN F. OLSON ET AL., GIBSON, DUNN & CRUTCHER LLP, *DIRECTOR AND OFFICER INDEMNIFICATION AND INSURANCE—ISSUES FOR PUBLIC COMPANIES TO CONSIDER* 3 (2013).

95. Chris Cumming, *Liability Concerns Impede Director Recruitment at Banks*, AM. BANKER (Apr. 17, 2014, 3:43 PM), [http://www.americanbanker.com/issues/179\\_75/liability-concerns-impede-director-recruitment-at-banks-1066974-1.html](http://www.americanbanker.com/issues/179_75/liability-concerns-impede-director-recruitment-at-banks-1066974-1.html).

96. CHERNIN ET AL., *supra* note 75, at 2.

97. *Id.* at 11.

98. Paul Shukovsky, *FDIC Settles with Former WaMu Executives for \$64 Million; Personal Loss Said Minimal*, 97 *Banking Rep.* (BNA) No. 23, at 1042, 1042 (Dec. 14, 2011).

99. VORYS, CLIENT ALERT: PROFESSIONAL LIABILITY AND THE FDIC; THE INDYMAC DECISION (Jan. 2, 2013).

100. Louise Story, *Ex-Bank Executives Settle F.D.I.C. Lawsuit*, N.Y. TIMES, Dec. 14, 2011, at B5.

101. William K. Black, *Which Aspect of the FDIC's Litigation Failures is the Most Embarrassing and Damaging*, NEW ECON. PERSPECTIVES (Mar. 12, 2013), <http://neweconomicperspectives.org/2013/03/which-aspect-of-the-fdics-litigation-failures-is-the-most-embarrassing-and-damaging.html>.

102. *Id.*

103. *Id.*

## V. BANKS' INSULATION OF DIRECTORS FROM PERSONAL LIABILITY

The first line of defense available to directors is an indemnification agreement, with D&O insurance serving as the second line of defense.<sup>104</sup> Most banks elect to use both an indemnification agreement and D&O insurance policy to insulate directors from personal liability.<sup>105</sup> As a prerequisite to accepting a director position at a bank, many directors seek assurance that their personal assets are protected by not only the promise of indemnification from the corporation but also a D&O insurance policy from an external insurance company.<sup>106</sup> The two forms of coverage are typically designed to work in conjunction, with the standard D&O policy presuming that the bank will first provide a director the maximum amount of indemnification legally allowed by the law of the bank's state of incorporation, and with the D&O policy supplementing any claim that the director is not indemnified against.<sup>107</sup> The combination of these two mechanisms provide directors with broad and thorough coverage against personal liability because the D&O policy will fill any gaps in the indemnification policy's first line of defense.<sup>108</sup>

A. *Indemnification Agreements*

Indemnification agreements function separately from the typical indemnification provision contained in a bank's bylaws.<sup>109</sup> Indemnification agreements create a stronger contractual obligation between the director and the bank so that the bank will indemnify a director "whose conduct meets the applicable standard" and advance expenses to the director for her defense against professional liability

---

104. Joanna Page, *Roundtable: Risks Facing Directors and Officers*, FINANCIER WORLDWIDE MAG., Aug. 2013, at 9 (quoting Leslie Kurshan).

105. Theodore J. Sawicki et al., *Not Just Belt and Suspenders: Indemnification Agreements and State Corporate Law*, 42 BANK & CORP. GOVERNANCE L. REP. 607, 609 (2009).

106. Jeanne Oronzio Wermuth, *Why Purchase Side 'A' Directors & Officers Liability Coverage?*, INS. J., June 18, 2012, at N4, 1.

107. SARAH TURPIN & FRANK THOMPSON, K&L GATES, DIRECTORS IN CRISIS 27 (2012), available at [http://www.klgates.com/files/Publication/7b5d50b9-8570-4759-aa60-121d2960a94e/Presentation/PublicationAttachment/666b0ad2-7697-4dca-999e-1930b415e6d9/CDR\\_Nov\\_Dec\\_2012.pdf](http://www.klgates.com/files/Publication/7b5d50b9-8570-4759-aa60-121d2960a94e/Presentation/PublicationAttachment/666b0ad2-7697-4dca-999e-1930b415e6d9/CDR_Nov_Dec_2012.pdf).

108. OLSON ET AL., *supra* note 94.

109. Sawicki et al., *supra* note 105, at 609.

claims.<sup>110</sup> While a bank may promise in its organizational documents to provide directors the maximum indemnification allowed under state law, in extreme circumstances, these bylaws may be amended by shareholder approval, thus potentially amending the indemnification provided within them.<sup>111</sup> This risk may be particularly high when the indemnified director no longer sits on the board.<sup>112</sup> By having a separate indemnification agreement, both current and former directors do not have to worry that the indemnification contained in the bylaws may be pulled out from underneath them.<sup>113</sup>

Indemnification agreements also clarify how indemnification provisions included in state law function in the real world.<sup>114</sup> State law generally provides corporations broad license to indemnify directors.<sup>115</sup> For example, Delaware general corporation law permits director indemnification subject to two basic conditions: (1) good faith; and (2) reasonable belief by the director that the conduct was lawful and in the corporation's best interests.<sup>116</sup> However, case law regarding dispute resolution in the event of an indemnification dispute and whether corporations are required to purchase D&O insurance is underdeveloped in states other than Delaware.<sup>117</sup> Therefore, a separate indemnification agreement can clarify details should the company have to indemnify the director.<sup>118</sup>

#### B. *D&O Insurance Policies*

D&O insurance was first introduced in the 1930s when state law did not permit corporations to indemnify their directors or officers; however, it did not initially take off because corporations did not see D&O personal liability as a significant risk.<sup>119</sup> While state legislatures

---

<sup>110.</sup> *Id.*

<sup>111.</sup> *Id.*

<sup>112.</sup> *Id.*

<sup>113.</sup> *Id.*

<sup>114.</sup> *Id.*

<sup>115.</sup> WILLIS HRH, EXECUTIVE RISKS ALERT: A-SIDE D&O FAQ 1 (June 2009), available at [http://www.willis.com/Documents/Publications/Services/Executive\\_Risks/2009/Executive\\_Risks\\_Alert\\_-\\_0609\\_-\\_A-Side\\_FAQs.pdf](http://www.willis.com/Documents/Publications/Services/Executive_Risks/2009/Executive_Risks_Alert_-_0609_-_A-Side_FAQs.pdf).

<sup>116.</sup> DEL. CODE ANN. tit. 8, § 141(e) (West 2014); *see also* Sawicki et al., *supra* note 105, at 609.

<sup>117.</sup> Sawicki et al., *supra* note 105, at 609.

<sup>118.</sup> *Id.*

<sup>119.</sup> DAVID GISCHE & MEREDITH WERNER, TROUTMAN SANDERS LLP, DIRECTORS AND

began permitting corporate indemnification in the 1940s and 1950s,<sup>120</sup> D&O personal liability protection—both indemnification agreements and insurance policies—did not become common until the 1960s.<sup>121</sup> Two 1968 decisions<sup>122</sup> held directors and officers personally liable despite not having profited personally from their behavior, ushering in a new world of director and officer liability.<sup>123</sup> D&O insurance policies became more popular<sup>124</sup> as corporations were forced to recognize the exposure that their directors and officers faced.<sup>125</sup> The percentage of major corporations carrying D&O insurance grew from approximately 10% in the early 1960s to 70–80% in 1971.<sup>126</sup> Today, almost all corporations, including banks, carry D&O insurance policies as additional protection for their directors and officers.<sup>127</sup>

Corporations purchase D&O insurance policies to protect directors and officers from personal liability arising from conduct executed in their official capacity.<sup>128</sup> Policies not only protect the directors and officers, but also the corporation itself, as these policies cover claims that the company might otherwise have to pay on behalf of its executives.<sup>129</sup>

D&O insurance policies may contain three “sides,” or types, of coverage.<sup>130</sup> The traditional policy, however, is only composed of two sides: Side A and Side B coverage.<sup>131</sup> Side A coverage (the only type that applies to directors and officers) protects directors and officers against claims that the corporation is legally prohibited against or

---

OFFICERS LIABILITY INSURANCE: AN OVERVIEW 1 (June 2011).

120. *Id.*

121. *Id.*

122. *See* SEC v. Tex. Gulf Sulphur, 401 F.2d 833 (2nd Cir. 1968), *cert. denied*, 394 U.S. 976 (1969) (holding that Texas Gulf and Sulfur and thirteen of its directors, officers, and employees violated Rule 10b-5).

123. Roberta Romano, *What Went Wrong with Directors’ & Officers’ Liability Insurance?*, 14 DEL. J. CORP. L. 1, 21–22 (1989).

124. GISCHE & WERNER, *supra* note 119, at 1.

125. *Id.*

126. Romano, *supra* note 123.

127. *Id.*

128. Tom Baker & Sean J. Griffith, *Predicting Corporate Governance Risk: Evidence from the Directors’ & Officers’ Liability Insurance Market*, 74 U. CHI. L. REV. 487, 494 (2007).

129. *Id.*

130. Christine Kang, *Directors’ and Officers’ Insurance: Ordinary Corporate Expense or Valuable Signaling Device?*, STAN. U. DEP’T OF ECON. (2011).

131. BAILEY CAVALIERI LLC, D&OPOLICY COMMENTARY 3.

feasibly incapable of indemnifying the director or officer.<sup>132</sup> Because it reaches non-indemnifiable claims and goes beyond the traditional D&O coverage, Side A coverage is known as “Broad Form” coverage.<sup>133</sup> Side A coverage also fills any gaps in indemnification created by state carve-out statutory exceptions, which explicitly prohibit indemnification in some circumstances.<sup>134</sup>

Side B coverage is also included in typical D&O insurance policies.<sup>135</sup> Rather than offering protection for the bank’s officers and directors, however, Side B coverage protects the bank’s finances.<sup>136</sup> Side B coverage reimburses the corporation for its losses in the event that the corporation has to indemnify a director or officer for claims brought against her.<sup>137</sup> Yet it does not offer the corporation protection for claims brought against the corporation itself.<sup>138</sup> Side C coverage does provide protection for claims brought by the bank against itself and is therefore often added to the traditional coverage.<sup>139</sup>

### C. Weaknesses in D&O Insurance Policies

While D&O insurance policies provide many benefits for directors, they also contain some weaknesses, which have worsened since the 2008 financial crisis.<sup>140</sup> First, the interaction between the three types of coverage can create financial risk for bank executives.<sup>141</sup> Most claims paid out under D&O insurance policies are under Side B or C coverage, leaving the policy limit depleted, and directors at risk.<sup>142</sup> Secondly, D&O insurance policies can be frozen during a bank’s

---

132. Stephen J. Weiss & Thomas H. Bentz, Jr., *Dedicated Limit D&O Insurance: An Abbreviated Guide to the Policies That Protect the Personal Assets of Directors and to the Officers*, METRO. CORP. COUNSEL, July 2007, at 29.

133. WILLIS HRH, *supra* note 115.

134. *Id.*

135. *Id.*

136. Weiss & Bentz, *supra* note 132, at 29.

137. GISCHE & WERNER, *supra* note 119, at 3.

138. *Id.*

139. BAILEY CAVALIERI LLC, *supra* note 130, at 3.

140. See, e.g., Benoit Carlier, *Impact of the Crisis on D&O SOLI Policies*, HUXLEY BANKING & FIN. SERVS. (June 2014), <http://www.huxley.com/insights-news/insights/impact-of-the-crisis-on-d-o-and-soli-policies>.

141. Weiss & Bentz, *supra* note 132.

142. *Id.*

receivership because they are technically assets of the bank.<sup>143</sup> In these situations, the once fully insured director is left to fend for herself.<sup>144</sup> Although “order of payment” provisions, which prioritize directors and officers over the corporation in terms of policy payouts, are often included in insurance policies, some question their effectiveness because the provision often applies only if the payments to the director and corporation are simultaneous.<sup>145</sup>

Moreover, policy exclusions may leave directors without protection.<sup>146</sup> Although D&O policies typically cover losses arising out of compensatory damages, settlement amounts, and legal fees,<sup>147</sup> this coverage is typically limited by three significant exclusions: (1) fraud; (2) prior claims; and (3) insured versus insured.<sup>148</sup> First, the “fraud” exclusion applies to claims alleging actual fraud or personal enrichment by the director.<sup>149</sup> The second exclusion, for “prior claims,” bars protection against claims “either noticed or pending prior to the commencement of the policy period.”<sup>150</sup> Finally, the “insured versus insured” exclusion states that insurers do not have to pay damages when two people covered by the same policy sue each other.<sup>151</sup>

Since the 2008 financial crisis, changes in D&O insurance policies have resulted in even less director coverage.<sup>152</sup> Many D&O insurance companies have experienced a decline in profit since the 2008 financial crisis due to the cost of defending against and settling claims.<sup>153</sup> As a result, these companies have now adopted stricter acceptance criteria, making D&O insurance policies harder to acquire.<sup>154</sup> The cost of D&O insurance coverage also increased immediately following the crisis, though there is some suggestion that this spike in coverage costs has now leveled off.<sup>155</sup> D&O insurance

---

143. *Id.*

144. *Id.*

145. BAILEY CAVALIERI LLC, *supra* note 130, at 2.

146. Baker & Griffith, *supra* note 128, at 500.

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. Cumming, *supra* note 95, at 3.

152. Benoit Carlier, *Impact of the Crisis on D&O SOLI Policies*, HUXLEY BANKING & FINANCIAL SERVICES (2014).

153. *Id.*

154. *Id.*

155. Joanna Page, *Roundtable: Risks Facing Directors and Officers*, FINANCIER

companies have also increased the exclusionary terms in D&O policies.<sup>156</sup>

For example, the “insured versus insured” exclusion has been widened to prohibit coverage of directors and officers who face FDIC professional liability suits.<sup>157</sup> In 2013, the U.S. District Court for the Northern District of Georgia held that the exclusion prohibits carriers from covering officers and directors sued by the FDIC as well.<sup>158</sup> For a bank with a traditional D&O insurance policy that covers both directors and the bank itself, an FDIC-as-receiver suit against the bank’s directors is ultimately an “insured versus insured” suit because the FDIC is acting as the bank.<sup>159</sup> This creates a gaping hole in policy coverage for the average bank, as D&O insurance policies are now prohibited from covering directors and officers sued by the FDIC.<sup>160</sup>

## VI. POTENTIAL EFFECTS OF INCREASED BANK DIRECTOR LIABILITY

For shareholders, there are significant advantages of holding bank directors personally liable for their decisions.<sup>161</sup> First and foremost, potential personal liability may further incentivize directors to prioritize compliance with federal regulations.<sup>162</sup> Banks have responded to stronger regulatory enforcement with enhanced compliance programs and an increased focus on risk exposure.<sup>163</sup> Additionally, increased risk of personal liability creates an incentive for banks and their directors to

---

WORLDWIDE MAG., Aug. 2013.

156. MITCHELL J. AUSLANDER ET AL., WILLKIE FARR & GALLAGHER LLP, FDIC ISSUES ADVISORY STATEMENT REGARDING D&O INSURANCE POLICIES, EXCLUSIONS, AND INDEMNIFICATION FOR CIVIL MONEY PENALTIES 1 (Oct. 2013).

157. Cumming, *supra* note 95, at 3.

158. St. Paul Mercury Ins. Co. v. Miller, 968 F. Supp. 2d 1236 (N.D. Ga. 2013); Kevin LaCroix, *D&O Insurance: Insured vs. Insured Exclusion Unambiguously Precludes Coverage for FDIC Failed Bank Lawsuit*, THE D&O DIARY (Sept. 16, 2014), <http://www.dandodiary.com/2013/09/articles/d-o-insurance/do-insurance-insured-vs-insured-exclusion-unambiguously-precludes-coverage-for-fdic-failed-bank-lawsuit/>; Cumming, *supra* note 95, at 3.

159. LaCroix, *supra* note 158, at 1.

160. Cumming, *supra* note 95, at 3.

161. Christopher Laursen, *Guest Post: BSA/AML Enforcement Trends and D&O Liability*, THE D&O DIARY (Apr. 4, 2014), <http://www.dandodiary.com/2014/04/articles/director-and-officer-liability/bsaaml-enforcement-trends-and-do-liability/>.

162. *Id.*

163. *Id.*

improve their corporate governance policies.<sup>164</sup> Corporations with histories of poor corporate governance are often forced to pay higher D&O insurance premiums because of the increased risk of coverage.<sup>165</sup>

Directors are negatively affected by the increased risk of personal financial liability.<sup>166</sup> After the 2008 financial crisis, “[i]t is now a much more serious responsibility to take on the role of director for any regulated entity”<sup>167</sup> because a director of a financial entity “is placing him or herself in the frame for very focused attention by regulators.”<sup>168</sup>

Additional, though indirect, negative implications of personal liability for directors are the circular process of heightened liability, more extensive D&O insurance policies, and the FDIC’s decision to bring suit where there are reachable D&O insurance policies.<sup>169</sup> In a situation in which the FDIC has been appointed as receiver of a bank, the FDIC’s analysis of whether or not to pursue a claim takes into account potential recovery.<sup>170</sup> Therefore, a heightened-liability atmosphere that leads banks to arm themselves with extensive D&O insurance policies could actually make the FDIC more likely to pursue a claim against a director because of the increased potential recovery.<sup>171</sup>

The increased risk of personal liability may also make it difficult for companies to recruit qualified directors.<sup>172</sup> A recent survey of 2,000 banks and savings institutions stated that in the past five years, 24.5% of respondents said that they had a director resign or refuse to serve on the board itself or on the board’s bank loan committee due to fear of personal liability.<sup>173</sup> This fear is exacerbated by a lack of information and transparency concerning the source of payment in

---

164. Sean J. Griffith, *Uncovering a Gatekeeper: Why the SEC Should Mandate Disclosure of Details Concerning Directors’ and Officers’ Liability Insurance Policies*, 154 U. PA. L. REV. 1147, 1181 (2006).

165. *Id.*

166. Page, *supra* note 155, at 4.

167. *Id.* at 9.

168. *Id.*

169. Sanjai Bhaga et al., *Managerial Indemnification and Liability Insurance: The Effect on Shareholder Wealth*, 54 J. RISK & INS. 721, 722 (1987).

170. FED. DEPOSIT INS. CORP., *supra* note 16, at 2.

171. *Id.*

172. Laursen, *supra* note 161.

173. *AABD Survey Results on Measuring Bank Director Fear of Personal Liability Are Not Good News*, AM. ASS’N OF BANK DIRECTORS (April 9, 2014), <http://aabd.org/aabd-survey-results-measuring-bank-director-fear-personal-liability-good-news/>.

FDIC settlements, as directors do not know the percentage paid by D&O insurance policies in comparison to director personal contributions.<sup>174</sup> Adding to the uncertainty and distress is the damage to a director's reputation, career, and future earnings, all of which are not compensable by insurance.<sup>175</sup> The increased number of FDIC professional liability suits along with the uncertainty of actual director out-of-pocket expenses have combined to make "bank directors and prospects . . . more concerned than ever about the extent of D&O coverage,"<sup>176</sup> and have made it increasingly difficult for banks to recruit and keep highly qualified directors.<sup>177</sup>

Also of concern is the potential for less innovation and positive development within banks as directors focus more on self-preservation and less on good, but potentially risky, business decisions.<sup>178</sup> In a business environment which often reveres a daring and inventive approach to firm strategy and development, the mentality of an under-protected director is at odds with the bold approach demanded by the market and shareholders.<sup>179</sup> As innovation often comes with a higher degree of risk than more traditional and conservative approaches, directors whose personal finances are at stake may be less willing to make innovative choices,<sup>180</sup> and the long-term health and success of the bank could be negatively effected as a result.<sup>181</sup>

## VII. RECOMMENDATIONS AND CONCLUSION

While U.S. consumers and regulators have been calling for heightened personal liability since the 2008 financial crisis, it is clear that the overall effects of increased personal liability are negative. To address the disparity among these desires and the practical effects, the industry should implement a system that has the same effect of director

---

174. Cumming, *supra* note 95, at 2.

175. *Id.*

176. Page, *supra* note 155.

177. Cumming, *supra* note 95, at 3.

178. Kevin L. Petrasic et al., *Getting Personal-Regulators' Drumbeat Warns of a New Era of Individual Responsibility*, 102 Banking Rep. (BNA) No. 17, at 783, 785 (May 5, 2014).

179. See Bhaga, *supra* note 169.

180. Raul J. Palabrica, *Directors and Officers Insurance*, PHIL. DAILY INQUIRER (Jul. 14, 2014, 12:41 AM), <http://business.inquirer.net/174621/directors-and-officers-insurance>.

181. *Id.*

personal liability from consumer and regulator standpoints while still offering directors some protection. This system should involve an increase in accountability and transparency at the executive level through strengthening corporate governance practices and publicizing re-designed corporate governance indices.<sup>182</sup>

Improving corporate governance systems within financial institutions is a key component of increasing accountability and promoting cultures that emphasize responsible practices.<sup>183</sup> Efforts by financial institutions in this area so far have included elevating risk-management priorities by adding or promoting Chief Risk Officers and establishing a risk committee within the board.<sup>184</sup> In a recent survey of major financial institutions, Ernst & Young found that 34% of respondents have added board members with risk expertise.<sup>185</sup> Other proposed changes include separating the management and control functions of banks and promoting long-term orientation of executive compensation and decision-making in order to align directors' personal interests with those of the financial institution.<sup>186</sup>

In addition to improving corporate governance systems within banks, the industry should redesign the corporate governance reports used to evaluate these systems.<sup>187</sup> Current corporate governance indices use measurements such as shareholder rights and board entrenchment as an indication of a corporation's corporate environment,<sup>188</sup> but more thorough and routinely executed assessments by external parties could provide more accurate insight into the performance of a corporation's

---

182. Klaus J. Hopt, *Better Governance of Financial Institutions*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 3, 2013, 9:26 AM), <http://blogs.law.harvard.edu/corpgov/2013/04/03/better-governance-of-financial-institutions/>; Pasquale Di Benedetto & Andreas Grimminger, *How Stock Exchange Indices Can Advance Good Corporate Governance Practices*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Sept. 25, 2013, 9:23am), <http://blogs.law.harvard.edu/corpgov/2013/09/25/how-stock-exchange-indices-can-advance-good-corporate-governance-practices/>.

183. Hopt, *supra* note 182; Benedetto & Grimminger, *supra* note 182.

184. Hopt, *supra* note 182; Benedetto & Grimminger, *supra* note 182.

185. ERNST & YOUNG, REMAKING FINANCIAL SERVICES: RISK MANAGEMENT FIVE YEARS AFTER THE CRISIS: A SURVEY OF MAJOR FINANCIAL INSTITUTIONS 26 (2013), available at [http://www.ey.com/Publication/vwLUAssets/Remaking\\_financial\\_services\\_-\\_risk\\_management\\_five\\_years\\_after\\_the\\_crisis\\_-\\_Complete/\\$FILE/EY-Remaking\\_financial\\_services\\_risk\\_management\\_five\\_years\\_after\\_the\\_crisis.pdf](http://www.ey.com/Publication/vwLUAssets/Remaking_financial_services_-_risk_management_five_years_after_the_crisis_-_Complete/$FILE/EY-Remaking_financial_services_risk_management_five_years_after_the_crisis.pdf).

186. Hopt, *supra* note 182.

187. Kang, *supra* note 129, at 6.

188. Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257 (2008).

executives and policies.<sup>189</sup> Such assessments would examine a corporation's culture and character, including executive compensation policies and other incentive practices, executive turnover, and internal controls such as revenue recognition procedures.<sup>190</sup> These factors, which are commonly used by D&O liability insurers to decide which corporations they will insure,<sup>191</sup> are considered to be "at least as important as and perhaps more important than other, more readily observable governance factors in assessing director liability risk."<sup>192</sup>

These more in-depth and focused assessments should then be made public to shareholders and the market regularly, in order to allow investors to make more informed investment decisions, and thereby create a market valuation of banks that consistently incorporates unbiased corporate governance information.<sup>193</sup> Investors will not only benefit from corporate governance indices through access to reliable information, but it will also incentivize banks to maintain strong corporate governance systems.<sup>194</sup> Emphasizing corporate governance policies will increase internal stability and releasing these redesigned corporate governance indices will provide banks with an opportunity to differentiate themselves from their peers in the market, as well as potentially increasing access to credit.<sup>195</sup>

Although increasing accountability and responsibility among directors and officers is critical, pursuing this objective through director and officer personal liability produces negative effects for directors, shareholders, and firms. The same goal of executive accountability and responsibility can be achieved by focusing instead on corporate governance practices and policies implemented by financial institutions as well as by allowing access to reliable and in-depth information regarding these practices for the firm's shareholders and general investors in the market.

EMILY S. MAY

---

189. Kang, *supra* note 129, at 17.

190. Baker & Griffith, *supra* note 128, at 519.

191. *Id.* at 517–20.

192. *Id.* at 500.

193. Kang, *supra* note 129, at 6.

194. Di Benedetta & Grimminger, *supra* note 182.

195. *Id.*