FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20429

Legal Division

Statement Concerning the Responsibilities of Bank Directors and Officers

The Federal Deposit Insurance Corporation is issuing this statement in response to concerns expressed by representatives of the banking industry and others regarding civil damage litigation risks to directors and officers of federally insured banks.

Duties of Directors and Officers

Service as a director or officer of a federally insured bank represents an important business assignment that carries with it commensurate duties and responsibilities.[1]

Banks need to be able to attract and to retain experienced and conscientious directors and officers. When an institution becomes troubled, it is especially important that it have the benefit of the advice and direction of people whose experience and talents enable them to exercise sound and prudent judgment.

Directors and officers of banks have obligations to discharge duties owed to their institution and to the shareholders and creditors of their institutions, and to comply with federal and state statutes, rules and regulations. Similar to the responsibilities owed by directors and officers of all business corporations, these duties include the duties of loyalty and care.

The duty of loyalty requires directors and officers to administer the affairs of the bank with candor, personal honesty and integrity. They are prohibited from advancing their own personal or business interests, or those of others, at the expense of the bank.

The duty of care requires directors and officers to act as prudent and diligent business persons in conducting the affairs of the bank.

This means that directors are responsible for selecting, monitoring, and evaluating competent management; establishing business strategies and policies; monitoring and assessing the

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[1] The regulatory agencies and others have produced guides that provide useful advice on ways directors can meet their duties to their institutions. These include the Pocket Guide for Directors (FDIC, 1988), The Director's Book (OCC, 1987), and FHLBB, Memorandum No. R 62, reprinted at 52 Fed. Reg. 22,682, 22,683 (1987). See also The Director's Guide: The Role and Responsibilities of a Savings Institution Director (FHLB-SF, 1988).

progress of business operations; establishing and monitoring adherence to policies and procedures required by statute, regulation, and principles of safety and soundness; and for making business decisions on the basis of fully informed and meaningful deliberation.

Officers are responsible for running the day to day operations of the institution in compliance with applicable laws, rules, regulations and the principles of safety and soundness. This responsibility includes implementing appropriate policies and business objectives.

Directors must require and management must provide the directors with timely and ample information to discharge board responsibilities. Directors also are responsible for requiring management to respond promptly to supervisory criticism. Open and honest communication between the board and management of the bank and the regulators is extremely important.

The FDIC will not bring civil suits against directors and officers who fulfill their responsibilities, including the duties of loyalty and care, and who make reasonable business judgments on a fully informed basis and after proper deliberation.

Procedures Followed to Institute Civil Lawsuits

Lawsuits brought by the FDIC against former directors and officers of failed banks are instituted on the basis of detailed investigations conducted by the FDIC. Suits are not brought lightly or in haste.

The filing of such lawsuits is authorized only after a rigorous review of the factual circumstances surrounding the failure of the bank. In addition to review by senior FDIC supervisory and legal staff, all lawsuits against former directors and officers require final approval by the FDIC Board of Directors or designee.

In most cases, the FDIC attempts to alert proposed defendants in advance of filing lawsuits in order to permit them to respond to proposed charges informally and to discuss the prospect of prefiling disposition or settlement of the proposed claims.

The FDIC brings suits only where they are believed to be sound on the merits and likely to be cost effective. On that basis, where investigations have been completed, the FDIC has brought suit (or settled claims) against former directors and officers with respect to 24% of the banks that have failed since 1985.

Nature of Suits Filed

The FDIC's lawsuits are premised on the established legal principles that govern the conduct of directors and officers. Lawsuits against former directors and officers of failed banks result from a demonstrated failure to satisfy the duties of loyalty and care. Most suits involve evidence falling into at least one of the following categories:

- Cases where the director or officer engaged in dishonest conduct or approved or condoned abusive transactions with insiders.
- Cases where a director or officer was responsible for the failure of an institution to adhere to applicable laws and regulations, its own policies or an agreement with a supervisory authority, or where the director or officer otherwise participated in a safety or soundness violation.
- Cases where directors failed to establish proper underwriting policies and to monitor adherence thereto, or approved loans that they knew or had reason to know were improperly underwritten, or, in the case of outside directors, where the board failed to heed warnings from regulators or professional advisors, or where officers either failed to adhere to such policies or otherwise engaged in improper extensions of credit. Examples of improper underwriting have included lending to a borrower without obtaining adequate financial information, where the collateral was obviously inadequate, or where the borrower clearly lacked the ability to pay.

One factor considered in determining whether to bring an action against a director is the distinction between inside and outside directors. An inside director is generally an officer of the institution, or a member of a control group. An inside director generally has greater knowledge of and direct day to day responsibility for the management of the institution.

By contrast, an outside director usually has no connection to the bank other than his directorship and, perhaps, is a small or nominal shareholder. Outside directors generally do not participate in the conduct of the day to day business operations of the institution. The most common suits brought against outside directors either involve insider abuse or situations where the directors failed to heed warnings from regulators, accountants, attorneys or others that there was a significant problem in the bank which required correction. In the latter instance, if the directors fail to take steps to implement corrective measures, and the problem continued, the directors may be held liable for losses incurred after the warnings were given.