THE D&O DIARY
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Cornerstone Research: FDIC Lawsuits Continue to Mount, Individuals Contributing Out-of-Pocket to FDIC Claims Settlements

By Kevin LaCroix on February 14, 2014

In 2013, the number of lawsuits the FDIC has filed against the directors and officers of failed banks reached the highest annual level during the current wave of failed bank litigation, though the pace of litigation filings peaked in the second quarter and slowed as the year progressed, according to the latest report from Cornerstone Research. The February 13, 2014 report, entitled "Characteristics of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions" (here), contains detailed analysis of the lawsuits that the FDIC has filed as well as the settlements the agency has reached so far. Cornerstone Research's February 13, 2014 press release regarding the report can be found here.

Among other things, the report contains very interesting analyses of the extent to which former directors and officers have been called upon contribute out of their own pockets toward the settlement of FDIC claims, as discussed below.

According to the report, the FDIC filed 40 D&O lawsuits in 2013, which represents a 54 percent increase over the 26 lawsuits the agency filed in 2012. The FDIC filed more lawsuits (15) during the second quarter of 2013 than it had filed in any quarter since the current wave of bank litigation commenced in 2010. However, the number of D&O lawsuits the agency filed declined each quarter as the year progressed; the agency filed 11 lawsuits in the third quarter and only 3 in the fourth quarter.

In total, from 2010 through year-end 2013, the FDIC filed 84 lawsuits involving 83 institutions. In January

2014, the agency filed three more lawsuits, but these latest lawsuits are not included in the Cornerstone Research analysis.

The increase in filing activity in early 2013 is consistent with the peak of the bank failures in 2009 and 2010, and in light of the three-year statute of limitations. FDIC lawsuits filed in 2013 primarily targeted institutions that failed in 2010 and to a lesser degree, 2009 (the suits involved with the earlier bank failures likely were the subject of an agreement tolling the statute of limitations). None of the 2013 lawsuits involved banks that had failed in years other than 2009 or 2010.

Overall, 17 percent of the 492 banks that failed between January 1, 2007 and year-end 2013 have been the subject of a D&O lawsuit. However, of the 140 banks that failed in 2009, the directors and officers of 64, or 46 percent, have been the subject of an FDIC lawsuit or have settled claims prior to a lawsuit. For the 157 banks that failed in 2010, the directors and officers of 53 institutions, or 34 percent, have been subject to a D&O lawsuit or have reached a settlement with the agency. Of the 92 bank failures during 2011, only one has been subject of a D&O lawsuit to date.

Though the peak numbers of bank failures was now over three years ago, banks have continued to fail, albeit at a diminished rate. During 2013, 24 institutions failed, representing a 53 percent decline in the annual number of failed banks from 51 in 2012. There were fewer bank failures in 2013 than there were in 2008, at the beginning of the financial crisis.

The number of bank failures declined during 2013 as the year progressed; there were twelve bank failures in the second quarter of 2013, six in the third quarter and only two in the fourth quarter. (There were an additional three bank failures in January 2014.) The banks that have failed more recently are smaller than the ones that failed earlier in the current bank crisis. The median total asset size of banks that failed in 2013 was $96 million, representing a 82 percent decline from the median total asset size of $528 million in 2008.

Of the failed bank lawsuits filed in 2013, 30 of the 40 lawsuits named inside and outside directors as defendants. Outside directors alone were named as defendants only in rare instances – in 8% of all lawsuits filed in 2013.

Fully 63 percent of the lawsuits filed between 2010 and 2013 involved failed banks from just four states – Georgia (19), California (12), Illinois (11), and Florida (11). It is hardly surprising that Georgia has the most failed bank lawsuits, as it is the state with the highest number of failed banks (88 through the end of 2013). Directors and officers of all three of the failed banks in Puerto Rico have been hit with FDIC lawsuits, and half of the failed Nevada banks have been targeted in D&O lawsuits.

The Cornerstone Research report has very detailed and interesting analysis of the settlements that the FDIC has reached so far – not just in the litigated matters, but in the matters that were settled separately without litigation. Including litigated matters and also including settlements with parties other than the former directors and officers of failed banks (for example, accountants, lawyers, adjusters, etc.), the agency has reached a total of 501 settlement agreements (which are available on the agency's website).

The report has very detailed analysis (on page 14) of the 17 litigated matters that have settled so far. Settlements in the D&O lawsuits total $120 million. The agency has also reached settlements of an additional $314 million in claims involving directors and officers that did not involve a lawsuit.

In what may be the single most interesting and important observation in the study, the report notes from a review of the settlement agreements on the agency's website, 39 of the 82 agreements that involve directors and officers (or 48 percent), involved out-of-pocket payments by the directors and officers. According to the report, directors and officers agreed to pay at least $42 million out of pocket in these cases.

Discussion

The Cornerstone Research has a wealth of interesting information and analysis about the FDIC's failed bank litigation. However, as noted above, the most interesting observation to me in the report is the statement that in 48 percent of the FDIC's settlements of lawsuits and claims involving directors and officers, individuals had to contribute toward the settlements out of their own pockets, and that total amount of their contributions is at least $42 million.

Aggregate figures are interesting and important, but they don't tell much of a story. It is difficult to tell from the bare numbers why the individuals had to pay out of pocket toward the settlement, what underlying circumstances contributed to the need for the individuals to pay, or whether or not the aggregate figure predominantly represents a few large settlements or a series of smaller settlements. More importantly, the aggregate figures don't capture the pain and financial sacrifice these settlements represent for the individuals involved.

In some (many? most?) cases where the individuals had to contribute out of their own pockets, insurance may not have been available or may not have been adequate to resolve the claims. It is hard to know at this point whether or not these individuals' banks had insurance options prior to the claim that were available but turned down that might have protected them from having to contribute. It is however indisputable that the individuals at banks that carried adequate limits and more protective terms and conditions would be less likely to be called upon to contribute out of their own pockets toward the settlement of any claims.

The surprising extent to which individuals have been called upon to contribute out of pocket toward the settlement of FDIC claims underscores the importance for banks (and indeed for any enterprise) to ensure that they have adequate D&O insurance limits and that they have the broadest insurance available in the marketplace.

The information about the individuals' contributions toward settlement highlights the fact that the placement of D&O insurance is an issue that potentially affects every individual director and officer. These individuals will want to ensure that their company has enlisted the assistance of a knowledgeable and experienced insurance broker in the placement of their insurance, to try to reduce to the maximum extent possible the chance that they might be called upon in the event of a claim to contribute out of their own personal assets toward settlement.

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