Professional Liability and the FDIC: Waiting for the Other Shoe to Drop

Since January 1, 2010, there have been 78 bank failures in the Untied States. (www.fdic.gov/bank/individual/failed/banklist.html., last accessed on June 1, 2010.) In 2007, there were three bank failures, 25 in 2008, and 140 in 2009. (FDIC *Quarterly, 2010, Vol. 4, No. 1, p. 17)* This upward trend, coupled with the current economic climate, creates the potential for continued escalation in the number of failed banks by the end of 2010. The number of Federal Deposit Insurance Corporation claims against professionals who have rendered services to banks and financial institutions, as well as directors and officers of those institutions, is also expected to increase concomitantly.

Role of the Federal Deposit Insurance Corporation

The Federal Deposit Insurance Corporation (FDIC) is the federal agency which regulates savings institutions and insures the deposits placed in those institutions. *12 U.S.C. Sec. 1818, et seq.* As such, it functions in a dual capacity. Its FDIC-Corporate role enables it to serve as a bank regulator and insurer of bank deposits. *12 U.S.C. Sec.1821 (a).*

As the FDIC-Receiver, however, it is the entity which acts as receiver for failed institutions, determining and assembling the failed institution's assets and making distributions to creditors. *12 U.S.C. Sec. 1821(d)(2)(A)* In its role as Receiver, various court decisions have recognized that liability alleged to have arisen from the acts or obligations of a failed bank is properly asserted solely against the FDIC as Receiver, rather than through its FDIC-Corporate function. *Perry Williams, Inc. v. FDIC, 47 F. Supp.2d 804, 808 (N.D. Tex, 1999)*

In its role as Receiver, the FDIC acquires rights, assets and privileges, including claims for losses caused by the wrongful conduct of directors, officers, attorneys, accountants, brokers and appraisers who provided services to the failed bank. These rights also encompass contract rights under director and officer liability policies and fidelity bond insurance "inherited" from the failed bank. *Managing the Crisis: The FDIC and RTC Experience 1980-1990, Federal Deposit Insurance Corporation, August, 1998, p.265*

The FDIC Professional Liability Program/History and Process

As a result of the banking crises of the 1980s early 1990s, the FDIC established its Professional Liability program. From 1990 through 1995, the FDIC and the Resolution Trust Corporation (RTC) collected $4.5 billion through this "professional liability operation". *Managing the Crisis, at 285* In recent years, recoveries through the program have diminished. For example, in 2001, the recovery was $128.6 million from professional liability claims for 41 failed institutions. *Audit of the Professional Liability Claims Process, Audit Report No. 02-019, May 31, 2002.* In 2008, the FDIC recovered only $31.2 million from its Professional Liability program. (*Statement of Martin J. Gruenberg, Vice Chairman, FDIC before the Financial Services Committee, U.S. House of Representatives, March 20, 2009, p.1*)

The *Audit* of the FDIC claims process provides an overview of the mechanism used by the FDIC to identify, develop, pursue and track professional liability claims during 1999, 2001, and 2002. Future recovery efforts are expected to be modeled on this approach. *Audit, p. 3*

The *Audit* also articulates a goal of close-out or authority to sue within 18 months of bank failure. The FDIC appears to have maintained this timeframe as its standard, reporting for the year 2008 that in 80% of all claim areas, a decision is made to close or pursue claims within 18 months of the failure date. *FDIC: 2008 Annual Report, Performance Results Summary.*

Future Investigative Efforts

As a result of the recent increase in the number of failed banks and litigation attendant upon these bank failures, the FDIC has significantly increased its legal staff in the Professional Liability Group, retained outside law firms to perform professional liability investigations and litigation, and added significantly to both its criminal and investigative staff. *State of Martin J. Gruenberg, page 2*

For each insured bank or thrift that fails, FDIC attorneys open 11 different types of professional liability investigations. These investigations are targeted to focus upon directors, officers, attorneys, accountants, fidelity bond carriers, appraisers, perpetrators of mortgage fraud, securities brokers, and commodity brokers. *Statement of Martin J. Gruenberg, page 2.*

Impact on Insurance Coverage: Exclusions

In light of the anticipated litigation, insurers, their attorneys and claims professionals should review the liability policy of *any professional* who rendered services to, or acted as a director or officer of, a failed financial institution. The policy should be examined to determine whether there are any exclusions or exclusionary endorsements applicable to banking regulatory claims. The most common coverage exclusions are the *regulatory exclusion clause* and the *insured versus insured clause*.

A *regulatory exclusion clause* in an insurance policy issued to a bank to provide insurance coverage for its officers and directors typically may declare that the policy does not apply to any action or proceeding brought by or on behalf of any federal or state regulatory or supervisory agency or deposit insurance organization. Such regulatory exclusions also may provide a sublimit applied to regulatory claims. *American Casualty Co. v. RTC, 839 F. Supp. 282, 292 (D.N.J. 1993)*; *Columbian Financial Corp. v. BancInsure, Inc. 2009 WL 4508576 (D. Kan. Nov. 30, 2009)* (The *Columbian* court determined that the Regulatory Exclusion *Endorsement* was applicable, and the policy did not terminate on the appointment of a receiver). Similar regulatory exclusions also may be attached to professional liability policies issued to attorneys and other professionals.

Insured versus insured exclusions provide that the insurer will not be liable to make any payments for loss in connection with claims made against officers and directors brought or maintained by or on behalf of an insured in any capacity. Under this exclusion, where a director or officer is sued by the corporation to recoup losses caused by unauthorized actions, coverage would not attach. *Biltmore Associates, LLC v. Twin City Fire Insurance Company, 572 F.3d 663,668 (2009)*(examining the exclusion in the context of bankruptcy and debtor in possession)

A review of the FDIC's documentation of its methods and processes of recovery used during the previous banking crises of the 1980s and 1990s is informative concerning the policies and procedures which the FDIC may implement in the near future in order to recover the substantial losses incurred as a result of the significant number of bank failures during the past two years.

While there has been no significant increase in the number of civil actions brought by the FDIC to recover the losses resulting from more than 218 recent bank failures, it appears likely that the FDIC will intensify its efforts to recover a large portion of those funds by pursuing professional liability claims within the next six months.

CNA Specialty Community Banks Program

CNA has been meeting the property, casualty and specialty insurance needs of community banks for over a quarter century. As a part of our ongoing efforts to increase CNA's market presence in the Community Banks business segment, we are currently investing in additional underwriting resources, improving processing systems and expanding our distribution initiatives in order to provide the foundation for positive future growth.

Our Community Banks appetite and program features include:

- Commercial banks, savings banks, savings and loan institutions and credit unions with up to $3 billion in assets
- Eligibility of de novo institutions
- Limits of up to $10,000,000 available for qualified insureds
- A majority of products issued on an admitted basis

We provide insurance products and solutions for community banks, such as:

- Financial Institutions Bond for Community Financial Institutions
- Epack[SM] Management Liability Pack, including Directors & Officers Liability, Entity Liability, Employment Practices Liability, Bankers' Professional Liability, and Fiduciary Liability
- Comprehensive Property and Casualty coverages
- CNA NetProtect®

The purpose of this article is to provide information, rather than advice or opinion. It is accurate to the best of the author's knowledge as of the date of the article. Accordingly, this article should not be viewed as a substitute for the guidance and recommendations of a retained professional. In addition, CNA does not endorse any coverages, systems, processes or protocols addressed herein unless they are produced or created by CNA. Any references to non-CNA Web sites are provided solely for convenience, and CNA disclaims any responsibility with respect to such Web sites.

To the extent this article contains any examples, please note that they are for illustrative purposes only and any similarity to actual individuals, entities, places or situations is unintentional and purely coincidental. In addition, any examples are not intended to establish any standards of care, to serve as legal advice appropriate for any particular factual situations, or to provide an acknowledgement that any given factual situation is covered under any CNA insurance policy. Please remember that only the relevant insurance policy can provide the actual terms, coverages, amounts, conditions and exclusions for an insured. All CNA products and services may not be available in all states and may be subject to change without notice. CNA is a registered trademark of CNA Financial Corporation. Copyright © 2010 CNA. All rights reserved. 6/10