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Alerts

FDIC Rules Designed to Claw Back Executive Compensation in Receivership Situations

July 26, 2011
Corporate / Financial Institutions Alert

The Federal Deposit Insurance Corporation (FDIC) recently voted to approve rules designed to further clarify application of its orderly liquidation authority detailed in the Dodd-Frank Act.

Of particular concern is Section 380.7 of the rules, which establishes criteria under which the FDIC (as receiver) will seek to recoup compensation from persons who are "substantially responsible" for a bank failure. Section 204(a) of the Dodd-Frank Act directs the FDIC to "take all steps necessary and appropriate to ensure that all parties, including management, directors and third parties, having responsibility for the condition of the financial company bear losses consistent with their responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility." In order to implement this directive, the FDIC is authorized to recover from senior executives and directors who were substantially responsible for a bank failure any compensation that they received during the two-year period preceding the date on which the FDIC was appointed as receiver, or during an unlimited time period in case of fraud.

Under the rule, the FDIC, when assessing senior executives' or directors' responsibility, will investigate:

- how the senior executive or director performed his or her duties and responsibilities; and
- the results of that performance, i.e., did it contribute to the failure.

If the executive or director has performed his or her responsibilities with a requisite degree of skill and care that an ordinarily prudent person in a like position would exercise under the circumstances, he or she will not be required to forfeit any compensation. This is a simple negligence standard. Thus, if a person is negligent, he or she may be forced to disgorge their compensation.

In the event of a failure, the FDIC will treat certain individuals as being substantially responsible for the company's financial condition. Most importantly, this responsibility will be presumed with respect to the chairman of the board of directors, chief executive officer, president, chief financial officer, or anyone who "acts in a similar role regardless of his or her title if in this role he or she had responsibility for the strategic, policy making, or company wide operational decisions of the" failed bank.

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As a consequence, any of the subject persons will be deemed to be substantially responsible for the failure. An individual may rebut the presumption by demonstrating that he or she performed his or her duties with the requisite degree of skill and care an ordinarily prudent person in a like position would exercise under the circumstances. However, the burden of proof will, under these rules, be placed upon a person if he serves in one of the capacities listed above. This will undoubtedly be a very difficult presumption to overcome.

Executives hired within the two years preceding the failure for the specific purpose of improving the bank's financial condition are not subject to this presumption. However, they still may be subject to the FDIC's recoupment power if it is determined that they were substantially responsible for the failure. Likewise, directors who join a board within the two years preceding the failure are not subject to the presumption if they joined pursuant to an agreement or resolution to assist in preventing further deterioration of the bank. Pursuing recoupment does not preclude the FDIC from pursuing any other claim that it might have against the senior executive officers and directors of a failed bank.

For more information, please contact Timothy M. Sullivan or your regular Hinshaw attorney.

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