



**AMERICAN
ASSOCIATION
OF BANK DIRECTORS**

National Capital Office

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February 3, 2012

Michael Krimminger, Esq.
General Counsel
FDIC
550 17th Street NW
Washington, D.C. 20429

Dear Mr. Krimminger:

It recently has come to AABD's attention that FDIC staff has reversed a long-standing position not objecting to bank directors' purchase of insurance to cover the risk of a civil money penalty, even if the coverage is in the form of an endorsement to a policy in the name of the bank or its holding company. We request that you review this matter and if you agree with AABD, make it known to banks and bank directors that they may continue to purchase insurance to cover that risk.

We understand that last summer, FDIC examiners cited at least two nonmember banks in Louisiana for violations of 12 C.F.R. § 359 for having an endorsement in their D&O policy that would indemnify directors for civil money penalties assessed against them. The policies were issued to the banks, but the banks did not pay for the coverage; the directors did.

This examiner interpretation of Part 359 was subsequently confirmed by an FDIC counsel.

We believe this interpretation is incorrect, as explained in this letter. In sum, neither the FDI Act nor Part 359 prohibits insurance for the payment of civil money penalties so long as the bank does not pay for it.

Summary of § 359 and Section 18(k) of the FDI Act

The provisions of 12.C.F.R. § 359.3 prohibit depository institutions or their holding companies from making or agreeing to make any prohibited indemnification payment except as permitted in the regulation.

“Prohibited indemnification payment” is defined to include any payment (or agreement or arrangement to make any payment) by any insured depository institution or an affiliated depository institution for an institution-affiliated party to pay or reimburse such person for any civil money penalty or judgment resulting from any administrative or civil action instituted by any federal banking agency. 12 C.F.R. § 359.1(l)(1)

“Institution-affiliated party” includes directors. 12 C.F.R. § 359.1(h).

“Payment” generally means any direct or indirect transfer of any funds or assets, any forgiveness of any debt obligations, and the conferring of any benefit (i.e., including stock options or stock appreciation rights). 12 C.F.R. § 359.1(k).

Michael Krimminger, Esq.
Page Two
February 3, 2012

One exception to the prohibition is any reasonable payment by an insured depository institution or depository institution holding company which is used to purchase any commercial insurance policy or fidelity bond, provided that such insurance policy or bond shall not be used to pay or reimburse an institution-affiliated party for the cost of any judgment or civil money penalty assessed against the person in an administrative proceeding or civil action commenced by any federal banking agency. 12 C.F.R. § 359.1(1)(2).

Our understanding is that the FDIC staff has based its interpretation on the language excepting certain payments by a bank or its holding company so long as the insurance being purchased by the bank or holding company does not pay civil money penalties or judgments as provided above.

This interpretation of the regulation is in error. The focus of the interpretation should be on the prohibition in 12 C.F.R. § 359.3 and the definition of "prohibited indemnification payment" in 12 C.F.R. § 359.1(l)(1), not on the exception to the prohibition.

The exception does not apply where there is no prohibited indemnification payment. Since the endorsement to the D&O policy in the name of the bank or holding company that insures against civil money penalties or judgments is not being paid by the bank or holding company, there is no prohibition in Part 359 on the D&O policy having such an endorsement or having the insurance carrier pay pursuant to the endorsement.

Because the endorsement and the payment pursuant to the endorsement are not prohibited indemnification payments, they are authorized under 12 C.F.R. § 359.5 (a). Also see 12 C.F.R. § 359.5(a)(3).

Part 359 tracks the provisions of Section 18(k) of the FDI Act very closely. There is nothing in Section 18(k) that would prohibit a bank director from paying for his own insurance.

Current Insurance Practices

It has been a long-standing practice for insurance carriers to add an endorsement to depository institutions' standard D&O liability policies which provides for the payment or indemnity by the carrier for any civil money penalty assessed against a director. According to common practice, neither the depository institution nor its holding company pays for that endorsement. The premiums for these endorsements are paid entirely by the applicable IAPs. We understand that this practice has existed since at least 1993, the year in which Part 359 was adopted, without protest by the FDIC.

Summary

Part 359 does not support the FDIC staff's recent interpretation that Part 359 bars bank directors from paying for insurance to cover the risk of a civil money penalty or judgment. We urge you to advise banks and bank directors as soon as possible that directors may pay for such coverage, even if it is in the form of an endorsement to a bank D&O policy or other bank insurance policy.

Insurance carrier representatives have advised me that there is a significant administrative burden on both banks and insurers to undo an insurance product that has been in existence for almost twenty years. They have also advised us that the carriers currently have no alternative vehicle to indemnify directors for the risk of an assessment of a civil money penalty. In addition to canceling thousands of existing contracts and attempting to reimburse premiums, a new method of indemnification would need to be created. This might create an increase in premiums because these policies would no longer be pooled into large groups to control the cost of insurance. This could potentially affect other forms of business insurance.

Michael Krimminger, Esq.
Page Three
February 3, 2012

For these reasons, it is important that you act quickly to advise banks and their directors that they may purchase insurance, even insurance in the form of an endorsement to a bank or holding company D&O policy, to cover assessments of civil money penalties and judgments derived from a federal banking agency action, so long as the bank or holding company is not paying for the endorsement.

Sincerely,

A handwritten signature in black ink that reads "David Baris" followed by a stylized flourish or initials.

David Baris
Executive Director