

SEC Charges Officers and Outside Directors with Fraud

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In charging senior leaders of a failed bank with fraud, the SEC also held two outside directors responsible.

Eleven executives and board members of the bank were charged by the SEC, which claimed that they improperly extended, renewed and rolled over bad loans in order to avoid impairment charges and reporting increased losses for loans and leases in its financial accounting. This contributed to the bank's failure in 2011 and the bank became the 26th largest bank by asset size to fail during the financial crisis.

The [SEC complaint](#) cites numerous specific loans and credit situations involving the bank's management. One of the directors was implicated in a particular restructuring when he agreed to assume some of the payments, but in fact was not personally liable due to other extensions of credit by the bank. The SEC alleged that the director either knew of the borrower's financial condition which rendered him unable to repay or was severely reckless with respect to his understanding of the borrower's condition.

This transaction was described in the related party section of the company's proxy statement as ordinary business and on substantially the same terms and conditions as comparable transactions with other customers. The SEC alleged that the transaction was neither arm's length nor in the ordinary course, so that the directors contributed to false and misleading statements in the proxy statement.

The remaining allegations against the directors focused on signing the Form 10-K, which contained false and misleading statements as to the bank's financial condition. In addition, the directors signed the reports of examination by the OTS and entered into memoranda of understanding, and the Form 10-K misstated the OTS restrictions on dividends.

The SEC complaint also accused the company of misleadingly stating in a Form 8-K that another director was "re-elected" when he had actually been "re-appointed" to the board. The SEC interpreted "re-elected" to mean by shareholders.

Each of the directors paid \$100,000 in penalties and all of the directors and officers were permanently barred from serving as officers and directors of a public company.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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