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Legal Sidebar

Silicon Valley Bank's Failure and Potential Director/Officer Liability

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On March 10, 2023, a California banking regulator closed Silicon Valley Bank (SVB), making it the second-largest bank by assets to fail in U.S. history. At the same time, the state regulator appointed the Federal Deposit Insurance Corporation (FDIC) as SVB's receiver to liquidate the institution, sell its assets, and pay claims against it. As receiver, the FDIC assumed all of the rights, powers, and obligations of SVB's officers, directors, and shareholders.

SVB's collapse prompted funding pressures at other banks, along with private and governmental emergency interventions aimed at protecting depositors and preventing the failure of other institutions. Questions abound about the causes of this distress. Since the FDIC has taken over SVB, a number of reports have surfaced that have raised questions about the potential culpability of the failed bank's former officers and directors. For example, there are reports that:

- SVB's primary federal regulator—the Board of Governors of the Federal Reserve System (Fed)—had, over the course of the last year and a half, issued SVB six supervisory warnings. These "Matters Requiring Attention" and "Matters Requiring Immediate Attention" reportedly concerned the bank's risk management practices. In early 2023, the Fed subjected the bank to a horizontal (cross-bank) examination regarding interest-rate risk, which identified additional deficiencies.
- SVB offered some of the most generous compensation packages among publicly traded banks. The bank also paid out bonuses to employees hours before the federal takeover.
- SVB executives sold millions of dollars of company stock shortly before the bank's collapse.
- The FDIC has estimated that SVB's failure will cost its Deposit Insurance Fund roughly $23 billion.

These reports have raised concerns that mismanagement caused SVB's failure and that executives reaped significant financial rewards despite the institution's collapse and associated costs to third parties. These reports have also prompted calls, including from some Members of Congress and the President, to hold SVB officers and directors accountable for the bank's downfall. Specifically, there have been calls for the federal government to recoup bonuses and other forms of compensation recently paid to SVB's officers

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and directors and to levy civil money penalties or otherwise hold bank executives personally liable for contributing to the bank's collapse.

This Legal Sidebar analyzes some of the existing legal authorities governing bank executive compensation, personal liability for officers and directors of failed banks, and investigations into possible insider trading by bank executives. The Sidebar concludes with potential options for Congress.

SVB Executive Compensation

In a proxy statement filed with the Securities and Exchange Commission (SEC) in March 2023, SVB's parent company—SVB Financial Group—described its executive compensation policies and procedures. The company noted that its Board of Directors and Compensation & Human Capital Committee determine the institution's executive compensation at least annually based on, among other things, market data regarding comparable institutions, recommendations from independent consultants, the company's financial growth and short- and long-term performance, market conditions, talent retention, and risk management.

As shown in **Figure 1**, SVB Financial reported providing executives a blend of base salaries, annual cash bonuses based on return on equity targets, long-term stock options and restricted stock units, long-term performance-based restricted stock units, and other benefits. SVB reported total compensation for its executive officers in 2022 ranging from just under $3 million for its General Counsel to just under $10 million for its CEO.

Figure 1. SVB Executive Compensation 2022

Compensation for Named Executive Officers

2022 Summary Compensation Table

The following table sets forth the compensation paid to our NEOs for the years ended December 31, 2022, 2021 and 2020, respectively:

Name and Principal Position	Year	Salary ($)(1)	Stock Awards ($)(2)	Stock Option Awards ($)(2)	Non-Equity Incentive Plan Compensation ($)(3)	All Other Compensation ($)(4)	Total ($)
Greg Becker *President & Chief Executive Officer*	2022	1,090,385	5,282,550	2,021,857	1,500,000	19,849	9,914,641
	2021	1,040,385	4,238,529	1,622,657	3,000,000	20,561	9,922,132
	2020	1,007,692	3,573,032	1,245,305	1,690,000	19,172	7,535,201
Dan Beck *Chief Financial Officer*	2022	740,385	1,584,901	606,515	625,000	19,526	3,576,327
	2021	680,769	1,199,285	459,072	1,400,000	20,561	3,759,687
	2020	604,616	992,397	345,882	830,000	4,176	2,777,071
Michael Descheneaux *President of Silicon Valley Bank*	2022	795,193	2,112,748	808,616	900,000	31,953	4,648,510
	2021	770,193	1,759,027	673,564	1,600,000	20,876	4,823,661
	2020	755,769	1,588,055	553,476	1,100,000	18,828	4,016,128
Philip Cox *Chief Operations Officer*	2022	685,577	1,320,049	505,464	325,000	45,744	2,881,834
	2021	620,193	1,119,484	428,553	1,200,000	48,026	3,416,256
	2020	604,616	992,397	345,882	800,000	296,423	3,039,318
Michael Zuckert(5) *General Counsel*	2022	665,385	990,393	379,098	615,000	19,494	2,669,370
	2021	620,193	878,951	336,782	1,075,000	20,561	2,931,487
Laura Izurieta(5)(6) *Former Chief Risk Officer*	2022	512,500	–	–	–	2,462,282	2,974,782

(1) The "Salary" column represents base salary paid to each NEO during the fiscal year, and includes amounts deferred under the Company's 401(k) Plan and Deferred Compensation Plan, as applicable. For 2022, the percentage of base salary with respect to total compensation for Messrs. Becker, Beck, Descheneaux, Cox, and Zuckert was 11%, 21%, 17%, 24%, and 25%, respectively.

(2) Values indicated for equity awards reflect the fair value of grants made during the fiscal year. Such values were computed in accordance with the Financial Accounting Standards Board Accounting Standards Codification Topic 718 ("ASC 718"). The amounts disclosed may never be realized. Assumptions used in calculating these amounts are included in the note entitled "Share-based Compensation" in our audited financial statements included in our Annual Report on Form 10-K for the applicable year. The amounts disclosed under the "Stock Awards" column also include the fair value of grants of certain performance-based restricted stock unit awards reported based on achievement at target level. The aggregate maximum grant date fair value of 2022 awards, assuming the highest level of achievement of the performance conditions (150% of the target level at grant date fair value) was $4,316,323, $1,295,008, $1,726,307, $1,078,803, and $809,241, for Messrs. Becker, Beck, Descheneaux, Cox, and Zuckert, respectively. For details of 2022 grants, see "Grants of Plan-Based Awards".

(3) Non-Equity Incentive Plan Compensation is comprised of ICP payments for each NEO. For 2022, the percentage of ICP payout with respect to total compensation for Messrs. Becker, Beck, Descheneaux, Cox and Zuckert was 15%, 17%, 19%, 11% and 23%, respectively.

(4) The following table provides the amounts of other compensation, including perquisites, paid to, or on behalf of, our NEOs during 2022 included in the "All Other Compensation" column. Perquisites and other personal benefits are valued on the basis of the aggregate incremental cost to the Company.

Source: SVB Financial Group Proxy Statement, Securities Exchange Comm'n Schedule 14A (filed March 2, 2023)

Regulation of Bank Executive Compensation

Executives of insured depository institutions (IDIs) are subject to statutory restrictions on compensation. Section 39 of the Federal Deposit Insurance Act (FDI Act), codified at 12 U.S.C. § 1831p-1, requires the federal banking regulators to implement standards that prevent officers, directors, principal shareholders, and employees of an IDI from receiving compensation that is either "excessive" or that "could lead to material financial loss to the institution."

The statute delineates a number of considerations for assessing the excessiveness of a compensation arrangement. These include the overall amount of compensation received by the individual, how much similarly situated individuals within the IDI and comparable institutions have historically been paid, the financial standing of the IDI, the cost and benefits to the IDI, and "any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution." The statute stipulates, however, that regulators may not use Section 39 to "set a specific level or range of compensation."

The Fed, FDIC, and Office of the Comptroller of the Currency (OCC) have adopted joint regulations to implement Section 39. The regulations define compensation broadly to mean all cash and noncash payments and benefits derived from, among other things, employment contracts and stock options. If a banking regulator determines that an IDI has failed to implement compensation policies that comply with Section 39 and its implementing regulations, then the regulator can require the IDI to make modifications to bring those policies into compliance.

The banking regulators also may use their enforcement powers, including their authority to issue Prompt Corrective Action Directives, Cease-and-Desist Orders, or Civil Money Penalty Orders, if the IDI "fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan." Whether the Fed raised concerns about SVB's executive compensation policies in advance of SVB's failure is unclear.

(Section 8(k) of the FDI Act also imposes limitations on payments under severance-related golden parachute agreements and indemnification agreements to institution-affiliated parties [IAPs]—i.e., officers, directors, employees, controlling shareholders, and certain other insiders. However, CRS has not found information suggesting that SVB made any such payments. As a result, the FDI Act's limits on golden parachutes and indemnification agreements are outside the scope of this Legal Sidebar.)

D&O Personal Liability: FIRREA & Fiduciary Duties of Care and Loyalty

Bank officers and directors generally owe fiduciary duties of loyalty and care to the banks they serve.

The FDIC explains that "[t]he duty of loyalty requires directors and officers to administer the affairs of the bank with candor, personal honesty and integrity." Bank directors and officers are thus "prohibited from advancing their own personal business interests, or those of others, at the expense of the bank."

The duty of care generally means that officers and directors are obligated to monitor the bank's activities and employees; to be informed of all material facts and circumstances when making decisions for the bank; and to ensure that bank decisions further a legitimate business purpose. The stringency of these duties, however, is often tempered in practice by the "business judgment rule," which can shield officers and directors from liability for bad business decisions—i.e., exercising poor judgment—as long as those decisions are rational and made in good faith, with full information, and absent conflicts of interest.

Prior to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which Congress passed in response to the savings and loan crisis of the 1980s, there was no federal statutory standard governing the fiduciary duties of bank officers and directors. Instead, bank officers and directors were subject to varying state corporate laws. A provision of FIRREA, codified at 12 U.S.C. § 1821(k), changed the relevant framework by establishing a statutory duty of care applicable to officers and directors of failed IDIs.

Under this provision, the FDIC, as receiver of a failed IDI, may hold officers and directors personally liable for civil monetary damages for "gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct," as defined by state law. The provision concludes with a savings clause that states that "[n]othing in this paragraph shall impair or affect any right of the Corporation under other applicable law."

The meaning of this provision was litigated in the 1990s. Some bank personnel argued that FIRREA established a uniform federal standard of gross negligence for directors and officers of failed banks. The

FDIC, in contrast, contended that the provision authorized, at a minimum, claims of gross negligence, as well as any lower standard that might be applicable under state law.

The Supreme Court ultimately sided with the FDIC in the 1997 decision *Atherton v. FDIC*. Relying largely on the provision's savings clause, the Court held that Section 1821(k) establishes a gross negligence floor, but also allows the FDIC to pursue claims against bank officers and directors under less stringent standards, such as simple negligence, when available under applicable state law.

As a result, the standards for bank officer and director liability vary state by state. These standards generally range from simple negligence (i.e., what a reasonably prudent person with similar experience would do in similar circumstances) to gross negligence (i.e., a heightened standard often requiring recklessness or willful indifference). Some states have also adopted various intermediate standards that apply in certain circumstances.

If the facts support claims for breach of the duty of care or loyalty, the FDIC would have the authority under Section 1821(k) to pursue claims against SVB officers and directors. Based on the case law applying this provision, such actions likely would be governed by the law of California, where SVB was headquartered and which served as the bank's principal place of business.

California Corporations Code § 309 codifies the business judgment rule as applicable only to corporate directors, not officers. Courts have interpreted the provision as protecting directors from liability for business decisions made in good faith and in the absence of fraud, corruption, a conflict of interest, or a total abdication of corporate responsibility. In other words, directors generally are subject to a gross negligence standard under California law, meaning liability depends on a showing that they acted without "even scant care" or in "an extreme departure from the ordinary standard of conduct."

In contrast, corporate *officers* are not protected by California's business judgment rule. Instead, officers, including those at SVB, can be liable for simple negligence under California law. Under that standard, SVB's officers owed a duty to the bank "to carry out their responsibilities by exercising the degree of care, skill, and diligence that ordinarily prudent persons in like positions would use under similar circumstances."

Notwithstanding the complexity of the applicable law, the FDIC has used its Section 1821(k) authority extensively. Since the 2008 financial crisis, the FDIC has filed dozens of lawsuits and entered into nearly 1,000 settlement agreements with officers, directors, and other professionals related to losses suffered by failed IDIs. These actions have led to recoveries totaling more than $4 billion.

The FDIC has noted, however, that it "will not bring civil suits against directors and officers who fulfill their responsibilities, including the duties of loyalty and care, and who make reasonable business judgments on a fully informed basis and after proper deliberation." The FDIC has stated that it largely brings personal liability cases against the officers and directors of failed banks in the following situations:

- dishonest conduct;
- inappropriate transactions with bank insiders;
- failure to establish, follow, or monitor sound underwriting policies and procedures; and
- failure to respond to concerns raised by regulators, accountants, counsel, or other professionals.

General Enforcement Powers Under 12 U.S.C. § 1818

Section 8 of the FDI Act (12 U.S.C. § 1818) also grants federal bank regulators certain authorities to hold bank executives accountable for misconduct.

Section 8(e) of the FDI Act empowers bank regulators to prohibit IAPs from participating in the affairs of any IDI in certain circumstances. To issue a prohibition order, bank regulators must make certain showings involving an IAP's misconduct, the effect of that misconduct, and the IAP's culpability for the misconduct.

Regulators can establish the relevant types of misconduct by proving that an IAP

- violated a law or regulation, final cease-and-desist order, written agreement between an IDI and a federal banking regulator, or a condition imposed in writing by a federal banking regulator in connection with granting an application or request by an IDI;
- engaged or participated in any unsafe or unsound banking practice; or
- breached a fiduciary duty.

If a regulator makes this showing, it then must establish that the effect of the IAP's misconduct was to

- cause the IDI to suffer actual or probable financial loss or other damage;
- actually or possibly prejudice the interests of the IDI's depositors; or
- cause the IAP to receive financial gain or other benefit.

Finally, to issue a prohibition order, a bank regulator must establish the IAP's culpability by showing that the relevant misconduct:

- involved personal dishonesty; or
- demonstrated willful or continuing disregard for the safety or soundness of the IDI.

Bank regulators can also seek civil money penalties from bank executives for certain types of misconduct under Section 8(i) of the FDI Act. Among other types of misconduct, Section 8(i) authorizes civil penalties against IAPs who recklessly engage in an unsafe or unsound practice in cases where the practice

- is part of a pattern of misconduct;
- causes or is likely to cause more than a minimal loss to an IDI; or
- results in pecuniary gain or other benefit to the IAP.

Insider Trading Investigations

The Department of Justice (DOJ) and Securities and Exchange Commission (SEC) are reportedly investigating stock sales conducted by SVB executives shortly before the bank's failure. On February 27—days before SVB disclosed large losses—SVB's CEO sold $3.6 million of the company's stock. Other executives also sold SVB shares in the months preceding the firm's collapse.

SEC Rule 10b-5 and Title 18 of the U.S. Code prohibit corporate insiders from trading their company's stock on the basis of material nonpublic information (MNPI). Under SEC Rule 10b5-1, however, insiders can avail themselves of an affirmative defense to insider-trading liability by utilizing trading plans that meet certain criteria. Some of the trades by SVB executives mentioned above, including the trades by SVB's CEO, were conducted pursuant to Rule 10b5-1 trading plans.

The use of a Rule 10b5-1 trading plan does not eliminate the possibility of an insider-trading violation. Among other requirements, insiders must adopt such plans before becoming aware of MNPI and must have entered into such plans "in good faith and not as part of a plan or scheme to evade" the insider-trading prohibition. The DOJ and SEC may bring insider-trading charges when these prerequisites are not met. Earlier this year, for example, the agencies filed insider-trading charges against a healthcare executive who allegedly adopted a trading plan while in possession of MNPI.

The SEC also recently overhauled Rule 10b5-1 in response to concerns about the abuse of trading plans. In December 2022, the agency finalized a regulation adding new conditions to Rule 10b5-1's affirmative defense. Among other things, the rule requires a "cooling off" period before trading can commence under a Rule 10b5-1 plan and restricts insiders' ability to use multiple overlapping plans—a practice that allowed executives to selectively cancel plans based on MNPI.

The SEC's amendments became effective on February 27, 2023, and generally do not apply to plans entered into before that date. Accordingly, it appears that the new requirements did not govern the sales by SVB executives that are reportedly under investigation. The sales by SVB's CEO—which were conducted on February 27 pursuant to a plan adopted on January 26—would not have complied with the amendments, which would have required a "cooling off" period of 90 days.

Considerations for Congress

Congress has several options to address concerns regarding the accountability of officers and directors of failed banks.

The Biden Administration has offered a number of proposals. The White House has argued that Congress should expand bank regulators' authority to seek penalties from negligent executives of failed banks. As discussed, Section 8(i) of the FDI Act allows regulators to obtain civil penalties from bank executives who recklessly engage in unsafe or unsound practices in certain circumstances. The Biden Administration has argued that Congress should expand this penalty authority to cover negligent conduct that contributes to a bank's failure.

Congress could also consider strengthening the FDIC's authority to obtain damages from officers and directors of failed banks. As discussed, 12 U.S.C. § 1821(k) establishes a federal floor of gross negligence for FDIC actions seeking damages from bank officers and directors. Less stringent burdens may apply, however, based on governing state law. To respond to accountability concerns raised by recent bank failures, Congress could consider establishing a uniform federal standard of simple negligence for bank officers and directors in FDIC damages actions.

The Biden Administration has also supported extending the clawback authorities in Title II of the Dodd-Frank Act to a broader set of institutions. When Title II's Orderly Liquidation Authority (OLA) is invoked to resolve large financial companies, the FDIC has express authority to recover compensation paid to executives and directors during the prior two years if such persons are deemed "substantially responsible" for a company's failure. FDIC regulations implementing this authority adopt a rebuttable presumption that certain executives and directors—including a firm's chairman, CEO, president, and CFO—are "substantially responsible" for a firm's failure.

OLA is currently available for resolving non-depository financial companies if certain statutory prerequisites involving systemic risk are satisfied. The Failed Bank Executives Clawback Act seeks to extend the clawback authorities available under OLA to resolutions of a wider range of institutions.

Congress is also considering broader changes to the FDIC's clawback powers. S. 825, the Protecting Consumers from Bailouts Act, would empower the FDIC to claw back any incentive-based compensation paid to an officer of a failed bank in the year preceding the FDIC's appointment as receiver. The aforementioned Failed Bank Executives Clawback Act would also require the FDIC to claw back several types of compensation paid to IAPs of failed banks during the five years preceding a bank's failure if such clawbacks are "necessary to prevent unjust enrichment and assure that the [IAP] bears losses" consistent with his or her responsibility.

Other proposals would use the tax code to recoup bonuses and profits from certain stock sales from executives of failed banks. The Deliver Executive Profits on Seized Institutions to Taxpayers (DEPOSIT) Act (S. 800) would adopt a 90% tax rate for bonuses paid to executives of a failed bank within the 60 days before the FDIC's appointment as conservator or receiver. The bill also would adopt a 100% tax rate on the profits from any transactions by executives of a failed bank in the bank's securities within the 60 days prior to the FDIC's appointment.

Another potential option is for Congress to take additional action to implement the executive compensation provisions of Dodd-Frank Act Section 956. Section 956 directed the federal banking regulators to promulgate regulations to bar certain incentive-based compensation arrangements at covered financial institutions with at least $1 billion in assets. In particular, the provision directed regulators to prohibit compensation arrangements that "encourage[] inappropriate risks" because they are "excessive" or could cause material losses to a covered institution. The statute required the banking regulators to issue these regulations within nine months of Dodd-Frank's enactment on July 21, 2010.

While the banking regulators proposed rules to implement Section 956 in both 2011 and 2016, they have not finalized them. The 2016 proposal would have, among other things, imposed a mandatory seven-year clawback of incentive-based pay received by certain senior executive officers who engaged in "significant misconduct," including actions that caused the financial institution significant reputational or financial harm.

Congress could codify any or all of the measures in the 2011 or 2016 proposals. Congress also could amend Section 956 so that its general prohibition of the relevant types of incentive-based pay goes into effect and is enforceable by a date certain, regardless of whether the banking regulators have finalized associated regulations.

Finally, Congress has the option to retain the current framework governing the liability of officers and directors of failed banks.

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