# Exec Liability Bill For Failed Banks Is Unnecessary, Unwise

By **Randall Guynn, Ledina Gocaj and Andrew Tynes** (May 31, 2024)

The U.S. Senate is considering the Recovering Executive Compensation from Unaccountable Practices, or RECOUP, Act, a bill that would grant the Federal Deposit Insurance Corp. new authority to claw back up to two years of compensation from senior executives of large banking organizations that fail.

Randall Guynn

The new authority would apply to any senior executive of a large banking organization, who, per the bill, "is responsible for [its] failed condition," as determined by the FDIC. A large banking organization would be any depository institution or depository institution holding company with total consolidated assets of more than $10 billion.

Ledina Gocaj

The bill is a reaction to what is alleged as the gross negligence of Silicon Valley Bank's senior management in betting that the Federal Reserve would reduce interest rates, which it instead raised. That bet, together with the bank's exposure to a run by a stampeding herd of uninsured depositors, allegedly caused the bank's failure.

As currently written, the bill is unnecessary and unwise.

Andrew Tynes

First, the FDIC already has the authority to hold senior executives personally liable for any damages to a failed bank caused by their gross negligence.[1] Those damages can include two years of compensation or more, but the FDIC would be required to prove that the damages were caused by management's gross negligence.

The proposed bill would not require the FDIC to show that a senior executive's business judgment about the risks a bank should take was grossly negligent. The FDIC would not need to show that such business judgment was inconsistent with the risks an ordinarily prudent bank executive would have allowed the bank to take. All it would have to show is that those risks caused the bank's failure.

The bill would effectively allow the FDIC to hold senior executives strictly liable for any mistakes in business judgment that caused a bank's failure with the benefit of hindsight, no matter how reasonable the decisions were at the time. It would be like allowing Monday morning quarterbacks to demand Patrick Mahomes share some of his compensation with them for mistakes he allegedly made the day before, no matter how reasonable his actions were in the heat of the game.

Second, holding bank executives strictly liable for their business judgment would be bad public policy. It would deter bank executives from allowing a bank to take reasonable risks. Deterring banks from taking reasonable risks is not in the public interest. It would unnecessarily reduce the supply of credit, payment instruments, and other banking products and services, and it would increase their costs.

It would also deter individuals who are most able to manage a bank from becoming bank

officers or directors. The competition for quality talent is intense. If the most able people would be held strictly liable for their business judgment at banks, why would they choose to manage banks rather than nonbanks?

Worse, the bill could make it impossible for the FDIC or other banking regulators to persuade the most able people to step in at the last minute to rescue a troubled bank from failing if they could be held strictly liable for failing to do so, despite even the most mighty and reasonable efforts.

Finally, some have argued that the bill is justified because bank executives had unlimited personal liability for a bank's losses until the middle of the 19th century.

That may have been true in other countries where banks were organized as general partnerships,[2] but it was never true for banks in the U.S. Instead, virtually all U.S. banks were chartered as banking corporations from the dawn of the republic. For example, the Bank of New York, the first state-chartered bank in the U.S. that is still operating, was chartered as a banking corporation by the New York Legislature in 1791.[3]

Historically, U.S. bank executives were liable only for losses caused by their negligence or gross negligence.[4] Bank shareholders were similarly liable only for losses up to the nominal amount of their investments or, between the Civil War and the Great Depression, double those investments.[5]

While the proposed new authority is unnecessary and unwise, it could be made consistent with existing law by specifying a gross negligence standard of care. At a minimum, the bill should be amended to specify a negligence or gross negligence standard of care.

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*Randall D. Guynn is chair of the financial institutions practice at Davis Polk & Wardwell LLP.*

*Ledina Gocaj is counsel at the firm. She previously served as senior policy adviser in the office of the chairman of the FDIC.*

*Andrew Tynes is an associate at Davis Polk.*

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[1] https://www.davispolk.com/insights/client-update/strict-liability-bank-leadership-unnecessary-and-unwise.

[2] See, e.g., James William Gilbart, The History of Banking in America pp. 78-81 (1837) (arguing that unlimited liability for bank shareholders and executives was the norm for banks in England because they were organized as general partnerships and that this made them safer than U.S. banks which were organized as chartered banking corporations with limited liability); Ernest Sykes, Banking and Currency pp. 96-97 (1905) (same with respect to English banks).

[3] An Act to Incorporate the Subscribers to the Bank of New York, ch. 37, 1791 N.Y. Laws 360-364.

[4] See, e.g., Julie Andersen Hill and Douglas K. Moll, The Duty of Care of Bank Officers and Directors, 68 Ala. L. Rev. 965 (2017); Atherton v. FDIC, 519 U.S. 213 (1997); N.Y. Banking Law § 7015.

[5] See, e.g., Jonathan R. Macey and Geoffrey P. Miller, Double Liability of Bank Shareholders: History and Implications, 27 Wake Forest L. Rev. 31, 35-38, 35 n.20 (1992).