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When Permission is Better (and Less Expensive) than Forgiveness

With more community banks operating under supervisory agreements with their regulators, it is important to remember that failure to secure prior approval for certain actions may result in regulatory sanctions, including civil money penalties. An ounce of prevention may avoid a pound of regulatory "cure."

Change in Executive Officer or Director

A bank operating under a formal supervisory action is prohibited from adding new executive officers or directors without the prior approval of the bank's regulators. In some instances, informal supervisory actions may also include this restriction. The agencies have a process by which, under certain circumstances, a bank may request a waiver of prior approval of these additions to key management and boards of directors. A formal request for a waiver is required but in many instances, the agencies will permit a bank to allow the new senior officer to function in that role while the agencies consider the formal Section 32 application. However, failure to request this waiver will result in regulatory criticism and possible sanctions.

Banks and bank holding company desiring to make changes in executive management or directorates should consult with regulatory counsel prior to making these decisions.

Golden Parachute Payments

More and more, we are seeing enforcement of Section 359 of the Federal Deposit Insurance Act which prohibits, except under certain circumstances, the payment of compensation to any institution-affiliated party ("IAP") upon the termination of the IAP's employment by the bank. A golden parachute payment means any payment (or agreement to make any payment) in the nature of compensation by any insured depository institution or an affiliated depository institution holding company for the benefit of any current or former IAP pursuant to an obligation of such institution or holding company if:

- the payment is contingent on, or by its terms is payable on or after, the termination of such party's primary employment or affiliation with the institution or holding company; and
- the payment is received on or after or is made in contemplation of any of the following:
 - the insolvency of the institution or the holding company; or
 - the appointment of a conservator or receiver for the institution; or
 - a determination by the institution's primary federal regulator that it is in troubled condition; or
 - the assignment of a composite rating of CAMELS 4 or 5 by the institution's primary federal regulator; or
 - the institution is subject to a proceeding to terminate its federal deposit insurance.

Section 359 also contains limited exceptions to the prohibition against paying golden parachute payments, but those exceptions are strictly construed.

An institution's primary federal regulator has the authority under Section 359.4 to permit

certain payments to IAP, but the institution or the IAP must make application for that permission in advance of payment. The applicant must be able to demonstrate that the IAP:

- has not committed any fraudulent act or omission, breach of fiduciary duty, or insider abuse with respect to the depository institution or its holding company that has had or is likely to have a material, adverse effect on the institution or its holding company;
- is not substantially responsible for the insolvency of, the appointment of a receiver for, or the troubled condition or the institution or its holding company;
- has not materially violated any applicable federal or state banking laws or regulations that have had or are likely to have a material effect on the institution or its holding company; and
- has not violated or conspired to violate certain sections of the United States Code that affecting a federally-insured financial institution.

Before making any payment to a departing IAP, banks and bank holding companies are advised to consult their regulatory counsel concerning these matters.

If you need additional information or assistance with these matters, you may contact a member of [Miller & Martin's Financial Services Practice Group](#).

Katie Edge	kedge@millermartin.com	615-744-8400
Beth Sims	bsims@millermartin.com	615-744-8490
Wayne Hood	whood@millermartin.com	615-744-8421
Adam G. Smith	agsmith@millermartin.com	615-744-8573
Mike Marshall	mmarshall@millermartin.com	404-962-6442

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1170 Peachtree Street,
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CHATTANOOGA

832 Georgia Avenue,
Suite 1000,
Volunteer Building
Chattanooga, TN 37402-
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NASHVILLE

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