



# 2024 PACB Convention

## Fulfilling Your Fiduciary Duty in a Challenging Business Environment

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# Learning Objectives

1. What is and to whom do we owe our Fiduciary Duty?
2. How has the fulfillment of our duty evolved over the years since the “GFC”?
3. How do we/I know we got it right?



# Introduction

- Every director owes fiduciary duties to the corporation and/or bank and its shareholders.
- Since directors can be subject to personal liability for breaches of these duties, it is important that they understand their obligations under the law.
- We will discuss:
  - The core fiduciary duties under PA law and PA and Federal banking law;
  - Specific director obligations that flow from these duties; and
  - How directors can limit their exposure to liability.



# Role of Directors

- Ultimate responsibility for the business and affairs of the corporation belongs to the directors.
- The board makes decisions on behalf of the corporation by:
  - Appointing officers to run the day-to-day operations of the corporation, proposing strategies and objectives, and implementing corporate plans;
  - Supervising the officers; and
  - Making major decisions for the corporation (such as M&A transactions, joint ventures, etc.).



# Sources of Director Duties

- The “corporate contract” consists of three components:
  - State Corporate Statute (PA Business Corporation Law)
  - Articles of Incorporation
  - Bylaws
- Fiduciary duties of the board are:
  - codified in law (state and federal)
  - a product of common law



# Board Fiduciary Duties

- The core fiduciary duties of the board of directors under PA law:
  - Duty of Good Faith
  - Duty of Care
  - Duty of Loyalty
- Other duties stem from these basic duties
- Additional duties prescribed federal banking law



# To Whom Are Fiduciary Duties Owed?

Directors owe their fiduciary duties to both:

- The corporation
- The shareholders



# Duty of Good Faith

- In fulfilling their responsibilities as a member of the corporation's board of directors, a director must discharge their duties as a director:
  - In good faith; and
  - In a manner they reasonably believe to be in the best interests of the corporation.



# Duty of Care

- The duty of care requires a director to act with a degree of care, including:
  - Skill and diligence that person of ordinary prudence would use under similar circumstances; and
  - Reasonable inquiry into issues required by law and those interests and factors listed in 15 Pa. C.S.A §§ 515(a) or 516(a) that the director considers appropriate.



## Duty of Care (cont'd)

- When performing their duties, directors are entitled to rely in good faith on information, opinions, reports or statements, including financial statements and other financial data prepared or presented by:
  - Officers or employees reasonably believed to be reliable and competent in matters presented;
  - Counsel, public accountants or other persons reasonably believed to be within the professional or expert competence of such person; and
  - Committees of the board as to matters reasonably believed to merit confidence.



## Duty of Care (cont'd)

- PA law permits directors to consider the effects of any action on groups affected by the action, including:
  - Shareholders
  - Members
  - Employees
  - Suppliers
  - Customers
  - Creditors
- Directors may also consider the effects on communities where offices or other establishments of the corporation are located.



# Duty of Care (cont'd)

- A shareholder may bring suit individually or on behalf of the corporation for violations of duty of care.
- Business judgment rule provides protection from liability under duty of care even if the decision harms the corporation or shareholders.
- The business judgment rule will apply if a director fulfills the duty of care if:
  - No self-dealing;
  - The director is informed about the decision to the extent he or she reasonably believes appropriate under the circumstances; and
  - The director rationally believes the decision is in the best interests of the corporation.
- Burden of proof is on person alleging violation of duty of care.



## Duty of Care (cont'd)

- The corporation's bylaws may eliminate directors' personal liability to the corporation or shareholders for breaches of their duties, unless:
  - The director has breached or failed to perform the duties; and
  - There is:
    - Self-Dealing;
    - Willful Misconduct; or
    - Recklessness.



# Duty of Loyalty

- The duty of loyalty prohibits self-dealing and misappropriation of corporate assets or opportunities by board members.
- Directors are expected to promote the common interests of shareholders, not their own interest.
- Directors must not, either directly or indirectly, use their position to obtain any personal profit or advantage other than that also enjoyed by shareholders.



## Duty of Loyalty (cont'd)

- Types of decisions and transactions that involve a conflict of interest may implicate a director's duty of loyalty:
  - Interested director transactions
  - Competing ventures
  - Usurpation of business opportunities
  - Self-dealing



# Duty of Loyalty (cont'd)

- Interested director transactions
  - The duty of loyalty requires disclosure of any conflicts of interest due to personal interest in the transaction.
  - PA law provides safe harbor for such transactions if:
    - Material facts of interest are disclosed and approved by majority of disinterested directors or of shareholders made in good faith; or
    - The transaction is fair to the corporation when entered.
  - Interested directors should recuse themselves.



# Duty of Loyalty (cont'd)

- Usurpation of business opportunity
  - If a director is presented with a business opportunity within the scope of the corporation's activities and of present or potential advantage to the corporation, law prohibits the director from appropriating the opportunity for himself without first presenting the opportunity to the corporation.
  - Has the director gained any unjust enrichment which rightfully should belong to the corporation.
  - PA law permits articles or board action may renounce any interest in a business opportunity or classes or categories of business opportunities



# Hot Topic

- Diversity, Equity, and Inclusion (DEI)
  - What is it?
  - Where are we?
  - What impact to fiduciary duties?



# Bottom Line

Directors should:

- Focus on overseeing the business, not learning corporate and banking law.
- Regularly attend and participate in board meetings.
- Make sure management prepares adequate reports before board meetings and that the board receives those reports well beforehand.
- Review reports and ask pertinent questions.
- Consult with counsel and experts as needed.
- Not avoid discussing conflicts of interest in the hope of keeping them off the record. Discuss them and keep a record reflecting that the board considered them.



# The Evolution of Fiduciary Duty Since the Great Financial Crisis of 2008

Question: How has the fulfillment of a director or officer's fiduciary duty to the financial institution evolved over the years since the "GFC"?



# GENERAL CORPORATE Fiduciary Duty

- **GENERAL Fiduciary Duty** = Corporate FD + Financial Industry FD
  - **Corporate FD** = FD to Corporation + FD to Shareholders
    - [[[See above Slides]]])
  - ++++++ **PLUS** ++++++
  - **Financial Industry FD** = Corporate FD + Regulatory Compliance FD + FD to Depositors, Customers, Shareholders, *Community*



# FINANCIAL INDUSTRY Fiduciary Duty

- Regulatory Compliance FD
  - Reports of Examination
  - Regulatory Compliance
  - Reporting – from Call Reports to Federal Securities Law filings
  - Examiners in the Bank
  - Disclosures to Depositors and safekeeping their money
  - Financial stability for shareholders



# FINANCIAL INDUSTRY Fiduciary Duty (continued)

- FD to Depositors, Customers, Shareholders, *Community*
  - FD to Depositors = transparency, disclosure, safekeeping
  - FD to Customers = depositors, borrowers, trust department clients, others per line of business
  - FD to Shareholders = making money, transparency, disclosures, **regulatory compliance**, litigation defense, customer service
  - FD to Community = good stewardship of the Financial Institution



# The 2008 Great Financial Crisis

- How it happened? –
  - Subprime, low doc, no doc, low interest rates
  - Housing bubble
  - Securitizations spread around the Country and the World
  - Result: Big trouble.



# The 2008 Great Financial Crisis (continued)

- Result of the Result: New laws to keep it from happening again.
  - Federal Reserve 2008 and 2009 amendments to TILA regulations
    - Lenders must consider consumer's ability to repay high-priced mortgage loan
  - Congress passes Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)
    - Lenders must consider consumer's ability to repay ALL residential mortgage loans
    - Amend Mortgage laws – TILA GFE, HMDA disclosures
    - Created the Consumer Financial Protection Bureau (CFPB)
    - Financial Privacy – consumer personal financial information



# Evolution of Fiduciary Duty Since 2008

- Expands Director FD Responsibilities
  - How?
    - History, events, crises, laws, statutes, regulations, **regulatory compliance**, court cases, regulator relationships, consumer disclosures, transparency, media coverage, public perception.



# Summary of Financial Institutions Industry FD Areas for Directors

- Strategic Planning
- Implementation
- Regulatory Compliance
- Safety and Soundness – CAMELS
- Financial Stability – capital, prompt corrective action, CRA community reinvestment, CAMELS and IT
- Cybersecurity – IT, computer vendors, ransomware, cybertheft, fraud
- Risk Management – including Third Party Risk Management
- Internal Audits – Sarbanes- Oxley Act of 2002
- Conflicts of Interest



# Summary of Financial Institutions Industry FD Areas for Directors (continued)

- Hot button issues of the Day
  - Interest rate risk – inflation
  - Liquidity – Silicon Valley Bank \$209B 3.10.2023; Signature Bank \$110B 3.12.2023; First Republic Bank \$225B 5.1.2023
    - COMPARE to GFC Recession of 2008 – 25 banks failed
  - Real Estate Portfolio – commercial real estate
  - Cybersecurity
  - Artificial Intelligence – opportunities and threats
  - CFPB Focus Areas: overdraft fees, nonsufficient funds fees, junk fees, credit card late fees
  - Anti-money laundering – Bank Secrecy Act (BSA)
  - Fair Lending - anti-discrimination
  - Chevron is gone – Loper Bright fishing case is new standard



# Summary of Financial Institutions Industry FD Areas for Directors (continued)

- Enforcement Actions
  - Informal – Memorandum of Understanding (MOU), Matters Requiring Board Attention (MRBA), Board Resolutions. ARE NONPUBLIC.
  - Formal – Stipulated Orders, Written Agreements, Cease and Desist Orders Consent Order, Stipulated Order, Assessment of Civil Money Penalties (CMP), Prompt Corrective Action, Capital Directive, Safety and Soundness Orders. ARE PUBLIC.
  - Monetary Penalties – CMPs
  - Operational Penalties – Restrict growth, brokered deposit restrictions, remove directors and officers, no branching, no M&A, require restitution, capital restoration plan, other actions.



# Summary of Financial Institutions Industry FD Areas for Directors (continued)

- The 13 Factor CMP Test basically defines Fiduciary Duty of Financial Institutions that are in any level of trouble.
  - Federal Regulators may utilize the 13 Factors list to decide whether and in what dollar amount to impose CMPs: (1) intentional, (2) duration of violations, (3) continuation of violations, (4) failure to cooperate, (5) concealment of the violation, (6) harm to public, (7) insider gain, (8) restitution, (9) prior history of violation, (10) previous regulatory criticism, (11) compliance program present or absent, (12) tendency to violate law or engage in unsafe or unsound banking practices or breaches of fiduciary duty, and (13) existence of orders or agreements to prevent the violation.



# **Summary of Financial Institutions Industry FD Areas for Directors (continued)**

- Investigations by Regulators
  - Consumer Complaints
  - Examinations and Reports of Examination
  - Rule: Cooperate, tell the truth, respond promptly, disagree respectfully.
  - Consult legal counsel.



# Closing Thoughts

- How do I/we know we got it right?
  - Corporate FD
  - Financial Institution Industry FD
  - Diligence, Good Faith, Care, Loyalty
  - Avoid Conflicts of Interest
  - Experts
  - Well-informed Good Faith Actions
  - Business Judgement Rule



# Thank you!

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