



CALIFORNIA
BANKERS
ASSOCIATION

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Directors Boot Camp – Session One

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ROLES AND RESPONSIBILITIES OF DIRECTORS



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Fiduciary Duties of Directors

- Duty of loyalty
- Duty of care



Duty of Loyalty

- Take no unfair advantage
- Honor duty of full disclosure
- Avoid competitive acts



Duty of Loyalty

- Examples
 - Management Interlocks Act
 - Conflicts of interest/Codes of conduct
 - Insider lending (Regulation O)
 - Affiliate transactions (Regulation W)
 - Executive Compensation
 - Indemnification/D&O insurance
 - Insider trading



Duty of Care

- Exercise care in supervision as a prudent person in the management of his or her own affairs
- Exercise reasonable, informed business judgment
- Reasonably informed about performance, policies, procedures and controls



Conflicts of Interest and How to Deal with Them



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What is a Conflict of Interest?

- A Conflict of Interest conflicts with a person's observance of the standards of conduct
- Recognize & Disclose Conflicts of Interest
- Follow Applicable Standards of Conduct
 - Duty of Loyalty
 - Duty of Care



Dealing With Conflicts of Interest

- Identify areas of potential conflicts of interest
- Adopt a code of conduct
- Adopt an insider transaction policy
- Identify which insiders are covered



Dealing With Conflicts of Interest

- Identify material transactions for board approval
- Independently establish market terms or price
- Abstain from advocacy, decision and voting



Common Types

- Loans to insiders – Regulation O
- Affiliate transactions – Regulation W
- Nonlending business transactions and other conflicts of interest
- Insider stock trading
- Bank Bribery Act



REVIEW OF DIRECTOR & OFFICER LIABILITY ISSUES



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Ericson State Bank Case

- Background
 - John Poulson, the former President and a board member of the failed Ericson State Bank in Nebraska, began interfering with loans to a relative in 2015 by advancing bank funds above the approved loan amounts and changing payment due dates and loan maturity dates in the bank's computer system to conceal the loans' past-due status from the rest of the bank's board
 - Poulson's scheme to defraud continued until September of 2019, when the Nebraska Department of Banking and Finance removed Poulson from his positions of authority with the bank



Ericson State Bank Case

- Outcome
 - Poulson pleaded guilty to charges brought by the U.S. Department of Justice, and in August 2024 he was sentenced to 18 months in prison for bank fraud with an additional 5 years of supervised release
 - Poulson was also ordered to pay \$815,000 in restitution



Sonoma Valley Bank Case

- Background
 - Between 2004 and 2010 the former chief executive officer, Sean Clark Cutting, and former chief loan officer, Brian Scott Melland, of Sonoma Valley Bank, breached the duty of loyalty with multiple schemes to defraud numerous financial institutions. Cutting was also a board member.
 - The former officers approved loans to real estate developer Bijan Madjlessi in excess of \$35 million, which was approximately \$24.7 million more than the bank's legal lending limit. The lending limit violation was concealed by the loans being made to "straw" borrowers, but the officers knew the loan proceeds would be paid to Madjlessi and companies he controlled.
 - According to the acting U.S. Attorney, Alex G. Tse, the defendants' crimes directly caused the failure of Sonoma Valley Bank.



Sonoma Valley Bank Case

- Outcome
 - In 2018, Cutting and Melland were sentenced to prison for bank fraud, wire fraud, money laundering, falsifying bank records, lying to regulators and conspiracy



Winslow Santa Fe Credit Union Case

- Background
 - The former CEO of Winslow Santa Fe Credit Union (an NCUA-supervised credit union) conducted unauthorized cash withdrawals and transfers to accounts associated with family members, and issued checks from the credit union using forged signatures
 - The former CEO concealed her actions by making false entries in the credit union's financial statements and falsifying the amounts of cash held in the credit union's vault or deposited with another credit union



Winslow Santa Fe Credit Union Case

- Outcome
 - The former CEO pleaded guilty to the criminal charges brought against her for theft, embezzlement, and misapplication of \$2,205,000 belonging to the credit union between December 2012 and May 2019
 - In March 2022, a U.S. District Judge sentenced the former CEO to federal prison for 26 months, and she was ordered to pay \$2,360,100 in restitution



FDIC v. Loudermilk Case

- Background
 - It was alleged that Buckhead Community Bank's former directors and officers (collectively, "directors" in this discussion), who served on the Bank's loan committee, repeatedly violated the Bank's loan policy, underwriting requirements, banking regulations and prudent and sound banking practices as a result of an aggressive growth strategy they implemented from 2005 to 2007
 - During that time, the Bank's loan portfolio increased 240%, mostly from gains in its high-risk real estate and acquisition, development and construction loans
 - At the same time, however, the bank's adversely classified assets went from accounting for 12.62% of tier 1 capital to 236% of tier 1 capital



FDIC v. Loudermilk Case

- Outcome
 - The FDIC sued the directors for negligence and gross negligence in their management of the bank's loan portfolio which led to the institution's failure
 - On July 22, 2019, the Eleventh Circuit Court of Appeals upheld a \$5 million jury award in favor of the FDIC against the directors



BEST PRACTICES FOR BANK BOARDS



Best Practices for Boards

1. Select good board members

- Independence – being free of conflicts
- Time to devote to the job
- Attention – fully engaged and proactive
- Courage – willingness to deal with tough issues
- Curiosity – about the bank, the industry and trends impacting both



Best Practices for Boards

2. Adopt a meaningful agenda

- Review, revise and update your agenda
- Focus on committee reports
- Spend time on direction and progress of institution
- Add an educational component
- Provide board packages ahead of time



Best Practices for Boards

3. Ensure the board is provided with information (not just data)
 - Focus on key data points
 - Compare to budget, peers and prior year
 - Meaningful information in an understandable format



Best Practices for Boards

4. Encourage board participation

- Allow for dissenting views
- Empower directors to ask questions
- A useful question: Why?



Best Practices for Boards

5. Make the committees work

- Delegate to committees
- Have effective committee leadership
- Hold people accountable
- Rotate committee chairs as appropriate, to avoid burnout
- Keep minutes



Questions?





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We're adjourned!

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