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Financial Institution Litigation Update:

Financial Crisis Brings Surge in Securities Litigation Against Banks

BY THOMAS P. VARTANIAN, DANIEL E. LOEB, AND DOMINIC A. ARNI

The ongoing turmoil in the financial markets has shaken the foundation of the banking world. This crisis, which started with a crack in the armor of subprime mortgage loans, has grown into a global dilemma that threatens governments around the world with the collapse of their financial and credit markets. Many of the oldest and most revered financial firms in the U.S. have fallen or been rescued by the government.

Institutions that are fortunate enough to remain standing after the first wave of this crisis are faced with a bleak financial landscape littered with unprecedented challenges. Included in these challenges are a dramatic surge in federal securities class actions filed against banks and other financial institutions and a yet-to-come increase in actions brought by the Federal Deposit Insurance Corporation (FDIC) as receiver against parties deemed responsible for bank failures.

Perhaps not surprisingly, a recent study by the Stanford Law School Securities Class Action Clearinghouse and Cornerstone Research found that entities in the financial services sector were named as defendants in approximately half of the 210 securities class actions filed in the federal courts between January 1, 2008 and Dec. 15, 2008.[1] In contrast to 2007, in 2008, many of the nation's largest financial firms were targeted as defendants in those actions. In 2007, fewer than 10 percent of those entities were named as defendants in securities class actions; in 2008, that number jumped to more than 30 percent.[2] In addition, almost 90 percent of the securities class actions filed against large financial firms involved subprime mortgage and liquidity issues.[3]

Many of the defendants in those actions are banks and savings associations. This too is not surprising, given the recent spate of high-profile bank failures and the role of the mortgage market in creating the current financial environment. In 2008, 11 publicly-traded U.S. banks failed and were taken over by the FDIC.[4] Of those banks, five were named as defendants in securities class actions.[5] This trend is likely to continue, as six additional banks failed in January 2009.[6] However, this trend is not limited to failed institutions. In fact, many of the institutions named as defendants in recent filings are neither troubled nor on the FDIC's watch list.

Notwithstanding the well-known market disruptions underlying their lawsuits, plaintiffs' claims of securities fraud face significant hurdles. In fact, given the structure of the federal securities laws, the ongoing and widespread instability in the financial markets may un-

Messrs. Vartanian and Loeb are partners and Mr. Arni is an associate in the Washington, D.C. office of Fried, Frank, Harris, Shriver & Jacobson LLP. The authors regularly represent clients with regard to bank enforcement and litigation matters.

[1] Stanford Law School Securities Class Action Clearinghouse and Cornerstone Research, *Securities Class Action Filings – 2008: A Year in Review* (Jan. 6, 2009), at 2 [hereinafter "*Securities Class Action Filings*"].

[2] *See id.* at 7 ("Of the companies in the S&P 500 index that *Bloomberg* classifies as financial, 32.6 percent were defendants in 2008 [securities class action] filings compared to 9.4 percent just a year earlier.").

[3] *See id.* at 2.

[4] Fourteen privately-held banks also failed in 2008. *See* Federal Deposit Insurance Corporation, *FDIC: Failed Bank List* (Jan. 30, 2009), *available at* http://www.fdic.gov/bank/individual/failed/banklist.html; *Securities Class Action Filings*, *supra* note 1, at 23, 23 n.24.

[5] *See Securities Class Action Filings*, *supra* note 1, at 23.

[6] *See* Federal Deposit Insurance Corporation, *supra* note 4.

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dermine plaintiffs' abilities to pursue securities fraud claims. Nevertheless, banks are quickly learning that they must consider taking affirmative steps to reduce their exposure to liability under the federal securities laws.

Complaints Focus on Mortgage Issues

Most of the securities class actions filed against banks in 2008 assert claims under § 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act")[7] and Rule 10b-5 of the Securities Exchange Commission's regulations.[8] In those complaints, investors allege that they were injured when the banks knowingly or recklessly made false and misleading statements to the public or failed to disclose negative facts about their financial condition that would have been material to the public's investment decisions. Among other things, investors allege that banks knowingly made risky loans, imprudently invested in mortgage-backed securities, and overstated the value of their mortgage-related assets. Following are several notable examples of the many federal securities fraud class actions that were filed against banks in 2008.

Franklin Bank Corporation

Founded by mortgage securities pioneer Lewis Ranieri, Houston, Texas-based Franklin Bank Corporation was the bank holding company for Franklin Bank, S.S.B., which provided community and commercial banking services and originated single-family residential mortgage loans. Beginning in June 2008, investors filed a series of class action complaints in the U.S. District Court for the Southern District of Texas asserting claims against Franklin Bank Corporation, its CEO, and its CFO for violations of the Exchange Act, including § 10(b).

The complaints, which have been consolidated in an action captioned *In re Franklin Bank Corporation Securities Litigation*,[9] assert claims on behalf of investors who bought Franklin common stock between April 26, 2007 and May 1, 2008. In those complaints, the plaintiffs allege that the defendants made false and misleading statements regarding Franklin's business and financial results that artificially inflated its stock price. Among other things, the plaintiffs allege that the defendants knew, but concealed from the public, that (i) Franklin's assets included millions of dollars in impaired and risky securities, including mortgage-backed securities; (ii) the defendants failed to properly account for the impairment of the loans underlying Franklin's mortgage-related assets; (iii) the defendants failed to properly account for delinquent loans serviced by third parties; and (iv) Franklin's call reports and FDIC filings reflected its failure to properly account for losses on its mortgage loans and residential real estate owned properties.

The plaintiffs assert that the defendants only revealed the true facts after the market closed on May 1, 2008, when Franklin issued a press release announcing revisions to its call reports due to ongoing issues with its mortgage-related assets. The plaintiffs allege that this announcement caused Franklin's stock price to drop from $1.72 per share on May 1 to $1.29 per share on May 2.

Franklin's May 1 announcement did not mark the end of its troubles. On Nov. 7, 2008, while this lawsuit was pending before the district court, the FDIC seized Franklin Bank, S.S.B. and transferred its deposits to Prosperity Bank.[10] Shortly thereafter, Franklin filed for protection from its creditors under Chapter 7 of the bankruptcy laws.[11] As a result of Franklin's bankruptcy filing, in December 2008, the district court stayed the securities class action against the bank.

National City Corporation

Until recently, Cleveland, Ohio-based National City Corporation was one of the nation's largest financial holding companies and operated an extensive banking network throughout the Midwest and Florida. National City's network conducted commercial and retail banking, mortgage financing and servicing, consumer finance, and asset management.[12] In 2008, National City and certain of its officers and directors were named as defendants in a series of class actions filed in the U.S. District Court for the Northern District of Ohio asserting claims under the federal securities laws, state law, and the Employee Retirement Income Security Act of 1974 (ERISA). The district court consolidated those cases under the caption *In re National City Corporation Securities, Derivative & ERISA Litigation*.[13]

On June 13, 2008, the plaintiffs in the federal securities class action filed an amended complaint on behalf of investors who purchased National City common stock from April 30, 2007 through April 21, 2008. The plaintiffs allege, among other things, that the defendants violated § 10(b) of the Exchange Act by knowingly issuing false and misleading statements that caused National City's stock to trade at inflated prices. The plaintiffs also allege that the defendants knew, but concealed from investors, that (i) National City's subprime mortgages were a substantial risk to its financial position, (ii) National City had failed to adequately reserve for its mortgage-related exposure, and (iii) the defendants had no basis for their rosy predictions regarding National City's financial performance and future dividend payments.

[M]any of the institutions named as defendants in recent filings are neither troubled nor on the FDIC's watch list.

The plaintiffs maintain that the defendants' actions only came to light on January 2, 2008, when National

[7] 15 U.S.C. § 78j(b) (2008).
[8] 17 C.F.R. § 240.10b-5 (2008).
[9] No. 4:08-cv-01810 (S.D. Tex.).

[10] Karey Wutkowski, *UPDATE 2-US Authorities Seize Franklin Bank, Security Pacific*, Reuters, Nov. 7, 2008, *available at* http://www.reuters.com/article/marketsNews/idUSN0740964520081108.

[11] Jonathan Stempel, *Ranieri's Franklin Bank Files Chapter 7 Bankruptcy*, Reuters, Nov. 13, 2008, *available at* http://www.reuters.com/article/businessNews/idUSTRE4AC4JI20081113.

[12] Michael A. Fletcher, *Takeover by PNC Heralds Fall of a Cleveland Institution*, Wash. Post, Oct. 25, 2008, at A01.

[13] No. 08-CV-7000 (N.D. Ohio).

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City announced that it was reducing its quarterly dividend by 49 percent, from $0.41 per share to $0.21 per share. Following that announcement, National City's stock price dropped from $16.46 per share to $15.59 per share.

National City's financial woes deepened throughout the summer and fall of 2008. By late-October 2008, National City had lost more than 80 percent of its market value at the beginning of the year and was actively looking to sell itself to another bank. On October 24, 2008, at the urging of the Office of the Comptroller of the Currency, PNC Financial Services Group announced that it had agreed to acquire National City for $5.2 billion in PNC stock, financed in part with funds provided by the U.S. Treasury.[14] That acquisition was completed on December 31, 2008.[15]

IndyMac Bancorp, Inc.

Without question, one of the highest-profile casualties of the 2008 financial crisis was California-based IndyMac Bancorp, Inc., the holding company for IndyMac Bank, FSB. Until mid-2008, IndyMac Bank was the seventh largest savings and loan association and the second largest independent mortgage lender in the United States.[16]

On June 11, 2008, investors in IndyMac Bancorp filed the first of several class action complaints asserting claims under the federal securities laws against IndyMac Bancorp, its CEO, and its former CFO on behalf of investors who purchased IndyMac stock between April 26, 2007 and May 12, 2008. Those actions later were consolidated in the U.S. District Court for the Central District of California into a single action captioned *Folsom v. IndyMac Bancorp, Inc*.[17] The plaintiffs allege that the defendants violated the Exchange Act by knowingly issuing false and misleading statements to the public regarding IndyMac's financial health. For example, the plaintiffs allege that IndyMac misrepresented that it was appropriately managing risks, that it was financially sound, and that it would be insulated from the turmoil in the housing, mortgage, and credit markets because it was a prime lender, rather than a subprime lender. The plaintiffs further allege that, contrary to their public statements, the defendants knew of or recklessly disregarded IndyMac's failure to follow appropriate guidelines and practices for originating and securitizing risky mortgage loans. The plaintiffs allege that IndyMac's practices led to increased delinquency and default rates for its mortgage loans and made it difficult for IndyMac to raise capital by selling or securitizing its risky loans. The plaintiffs further allege that the bank's improper actions were only revealed gradually from November 2007 through May 2008, when IndyMac disclosed its financial woes to investors.

On July 11, 2008, IndyMac Bank was seized by the Office of Thrift Supervision and was placed into receivership by the FDIC. At the time, IndyMac's failure was estimated to be the second largest failure of a regulated thrift in U.S. history.[18] These events ultimately led IndyMac to file for protection under Chapter 7 of the U.S. bankruptcy laws on July 31, 2008.[19]

BankUnited Financial Corporation

In 2008, financial institutions in the Sunshine State were also targets of securities fraud class actions. One of those institutions was BankUnited Financial Corporation, the holding company for BankUnited, FSB, the largest banking institution headquartered in Florida. Among other things, BankUnited, FSB provides banking products and services to consumers and businesses located throughout southeastern Florida.[20]

In September 2008, BankUnited and three of its officers, including its founder, Alfred R. Camner, were named as defendants in federal securities class action complaints filed in the U.S. District Court for the Southern District of Florida.[21] Among other things, the plaintiffs allege that, from April 18, 2006 through June 18, 2008, the defendants violated § 10(b) of the Exchange Act by making false statements or failing to disclose information regarding (i) the losses that the bank would incur when interest rates reset on billions of dollars of pay-option arm mortgages that it had made;[22] (ii) the bank's inadequate appraisal process, which enabled borrowers to obtain mortgages that exceeded both the values of the underlying properties and their abilities to make payments on the loans; and (iii) the bank's policies regarding risky ''piggy-back'' loans, which enabled borrowers to fund their down payments. Like the plaintiffs in the other actions discussed above, BankUnited's investors claim that they were damaged when the bank's improper actions were belatedly revealed and its stock price plunged.

Plaintiffs Face High Legal Hurdles

At first blush, the market instability that led to increased securities fraud litigation against banks might seem to strengthen investors' positions in those actions. This first impression is misleading. Instead, the very market-wide disruptions that spawned the hoard of securities class actions in 2008 may reduce the likelihood of plaintiffs ultimately prevailing in those cases or settling for any significant sums. The reason for this counterintuitive result is the structure of the federal securities laws, which impose high burdens on plaintiffs.

As discussed above, most of the securities class actions filed against banks in 2008 assert claims under § 10(b) of the Exchange Act. To prevail on such a claim, a plaintiff must plead and prove that defendants ''(1) made misstatements or omissions of material fact; (2) with scienter [the required state of mind]; (3) in con-

[14] Fletcher, *supra* note 12, at A01.

[15] *PNC Completes National City Acquisition*, The Associated Press, Dec. 31, 2008.

[16] IndyMac Bancorp, Inc., Current Report (Form 8-K), Ex. 99.1, at 6 (May 12, 2008).

[17] No. CV 08-3812 (C.D. Cal.).

[18] Kathy M. Kristof & Andrea Chang, *IndyMac Bank Seized by Federal Regulators*, L.A. Times, July 12, 2008, *available at* http://articles.latimes.com/2008/jul/12/business/fi-indymac12.

[19] Jonathan Stempel, *IndyMac Bancorp Files for Chapter 7 Bankruptcy*, Reuters, Aug. 1, 2008, *available at* http://www.reuters.com/article/ousiv/idUSBNG5428920080802.

[20] BankUnited Fin. Corp., Current Report (Form 8-K), Ex. 99.1, at 2 (Oct. 24, 2008).

[21] *See, e.g., Waterford Twp. Gen. Employees Ret. Sys. v. BankUnited Fin. Corp.*, No. 08-CV-22572, (S.D. Fla.), filed Sept. 16, 2008.

[22] Pay-option arms are adjustable rate mortgages that enable borrowers to select their payment amounts during the initial periods of their loans.

nection with the purchase or sale of securities; (4) upon which plaintiffs relied; and (5) that plaintiffs' reliance was the proximate cause of their injury.''[23] With respect to a defendant's state of mind, a plaintiff must show that the defendant acted recklessly in making statements of present or historical facts (such as reports of a company's prior earnings) and acted with actual knowledge in making ''forward-looking'' statements (such as predictions, projections, earnings guidance, or other statements of future intent).[24] In addition, plaintiffs must satisfy the heightened pleading requirements of Federal Rule of Civil Procedure 9(b), which requires them to plead the facts and circumstances constituting the alleged fraud with particularity.[25]

Several of the issues that will likely impact investors' securities fraud claims include (i) the high standard for pleading scienter, (ii) the safe harbors that shelter forward-looking statements, and (iii) challenges in proving that the alleged fraud caused investors' losses.

Scienter

Allegations of scienter are often the most heavily litigated aspects of § 10(b) claims. In 1995, Congress responded to a growing concern over the large number of frivolous securities class actions that were flooding the federal courts by enacting the Private Securities Litigation Reform Act of 1995 (the ''PSLRA''),[26] which significantly raised the requirements for pleading scienter.[27] Among other things, the PSLRA requires plaintiffs to plead ''with particularity facts giving rise to a *strong inference* that the defendant acted with the required state of mind.''[28] In a fairly recent decision, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the U.S. Supreme Court clarified that plaintiffs must plead facts supporting a ''cogent and compelling'' inference of scienter that is ''strong'' when compared to other explanations for the defendants' actions.[29] The Court held that a complaint must be dismissed if the inference of scienter is not ''at least as compelling'' as any opposing inference that could be drawn from the alleged facts.[30] As a result, plaintiffs asserting securities fraud claims against banks must satisfy very high pleading burdens in order to survive motions to dismiss.

The unprecedented and continuing uncertainty in the financial markets may hinder plaintiffs' efforts to satisfy their pleading burdens. For example, plaintiffs may have difficulty pleading facts that give rise to a strong inference that a bank actually knew that its projections were false or misleading or that it knowingly or recklessly withheld material information that it should have disclosed. When an economic tsunami comes ashore and nothing is left standing, it becomes more difficult to prove that any particular firm could have anticipated such events. Of course, the size of a financial meltdown does not necessarily provide any mitigating impact when events that have already unfolded are later misrepresented to investors. Additionally, the nature and size of the economic downturn may also affect the potential liability of directors and officers to the FDIC as the receiver for failed banks. But more about that later.

[T]he very market-wide disruptions that spawned the hoard of securities class actions in 2008 may reduce the likelihood of plaintiffs ultimately prevailing in those cases or settling for any significant sums.

The recent decision by the U.S. District Court for the Southern District of Florida in *Hubbard v. BankAtlantic Bancorp, Inc.*[31] illustrates this challenge. In that case, an investor asserted claims against BankAtlantic Bancorp, Inc., the bank holding company for Florida-based BankAtlantic, and several of its directors and officers for violating the Exchange Act, including § 10(b). The complaint alleged that, from November 2005 through October 2007, BankAtlantic sought to capitalize on Florida's real estate boom by expanding its portfolio of risky commercial real estate loans, which it accomplished by violating its lending guidelines. The complaint also alleged that BankAtlantic did not establish adequate reserves for its losses relating to that portfolio, which caused its financial statements to contain material misstatements. When the Florida real estate mar-

[23] *Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 172 (2d Cir. 2005) (quoting *In re IBM Sec. Litig.*, 163 F.3d 102, 106 (2d Cir. 1998)). *See also* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; *In re Bristol-Myers Squibb Co. Sec. Litig.*, 586 F. Supp. 2d 148, 158-59 (S.D.N.Y. 2008).

[24] *See, e.g.*, *Helwig v. Vencor, Inc.*, 251 F.3d 540, 552 (6th Cir. 2001).

[25] *See* Fed. R. Civ. P. 9(b) (2008) (''In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake.''); *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007) (stating that claims under § 10(b) are subject to Rule 9(b), which ''serves to provide a defendant with fair notice of a plaintiff's claim, safeguard his reputation from improvident charges of wrongdoing, and protect him against strike suits'').

[26] Pub. L. No. 194-67, 109 Stat. 743 (1995) (codified at 15 U.S.C. § 78u-4(b)).

[27] *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2508 (2007) (noting that the PSLRA was ''[d]esigned to curb perceived abuses of the § 10(b) private action – 'nuisance filings, targeting of deep-pocket defendants, vexatious discovery requests and manipulation by class action lawyers' '' (quoting *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006))); *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 977-78 (9th Cir. 1999) (through the PSLRA, ''Congress generally intended to raise the pleading standards to eliminate abusive securities litigation'' that was filed '' 'whenever there [was] a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer' '' (quoting H.R. Conf. Rep. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730)); H.R. Conf. Rep. No. 104-369, at 41 (Congress adopted the PSLRA to ''prevent[] abuse of securities laws by private litigants'' by ''strengthen[ing] existing pleading requirements'' for securities fraud claims).

[28] 15 U.S.C. § 78u-4(b)(2) (2008) (emphasis added).

[29] 127 S. Ct. at 2510.

[30] *Id.* (''[T]he inference of scienter must be more than merely 'reasonable' or 'permissible' – it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.'' (quotations omitted)).

[31] No. 07-61542-CIV, 2008 WL 5250271 (S.D. Fla. Dec. 12, 2008).

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ket collapsed in 2007, borrowers defaulted on their loans, forcing BankAtlantic to disclose its exposure to those risky loans and the extent of its losses. Following that announcement, BankAtlantic's stock price dropped by almost 40%.[32]

On Dec. 12, 2008, the district court granted the defendants' motion to dismiss the complaint, holding that the plaintiffs' vague and conclusory allegations that the defendants knew or should have known facts that were contrary to their public statements fell "short of Congress's stringent test for pleading scienter."[33] Among other things, the court found that "[t]he argument that Defendants, looking back after the fall of the Florida real estate market, should have reserved more than they did does not reflect an extreme departure from the standards of ordinary care, and therefore, does not support a strong inference of scienter."[34]

As in *Hubbard*, investors' claims will be dismissed unless they plead specific facts creating a strong inference that the banks acted with scienter. Pleading only "fraud by hindsight" will not suffice.

Safe Harbors

In addition to establishing a heightened standard for pleading scienter, the PSLRA also created two safe harbors intended to shield defendants from liability for making certain forward-looking statements. The first safe harbor protects forward-looking statements that a defendant identifies as forward-looking and that are accompanied by meaningful cautionary language disclosing known risks that might cause the statement not to come true.[35] The second safe harbor protects forward-looking statements if the defendant lacked "actual knowledge" that the statement was false or misleading.[36] Thus, the safe harbor would shield a defendant that recklessly, but not knowingly, made a false or misleading forward-looking statement.[37]

The PSLRA's safe harbors could make it difficult for plaintiffs to prevail on claims challenging banks' forward-looking statements, including their earnings guidance. As a general matter, banks are highly-sophisticated financial institutions represented by in-house and outside counsel who are familiar with the federal securities laws. As a result, warnings likely will accompany most, if not all, of their forward-looking statements. Thus, litigation regarding banks' forward-looking statements likely will not turn on whether cautionary language accompanied those statements, but rather on the sufficiency of the banks' warnings given the facts that they knew when they made those statements.

Loss Causation

The dramatic fluctuations in the financial markets may also hinder investors' efforts to show that an alleged fraud caused their losses. Plaintiffs often attempt to plead this element of a § 10(b) claim by alleging that a defendant's fraud artificially inflated its stock price, that they purchased the stock at the inflated price, and that they suffered losses when the fraud was revealed and the stock price dropped. In the recent case of *Dura Pharmaceuticals, Inc. v. Broudo*,[38] however, the Supreme Court rejected this tactic and held that plaintiffs must plead facts showing a "causal connection" between the defendant's misrepresentation and the plaintiff's loss.[39] The Court explained that "the logical link between the inflated share purchase price and any later economic loss is not invariably strong" because a "lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price."[40]

When an economic tsunami comes ashore and nothing is left standing, it becomes more difficult to prove that any particular firm could have anticipated such events.

The recent changes in the financial landscape, including the collapse of longstanding pillars of Wall Street and the erratic movement of major stock indexes, could make it difficult for investors to show any "causal connection" between their losses and banks' allegedly false or misleading statements. In fact, some experts have speculated that this issue might have deterred investors from filing securities fraud class actions at the end of 2008.[41]

[32] *See id.* at *2-*6.
[33] *Id.* at *18.
[34] *Id.*
[35] *See* 15 U.S.C. § 78u5(c)(1)(A)(i) (providing that forward-looking statements are protected if they are identified as forward-looking and "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement[s]"); *In re Sierra Wireless, Inc. Sec. Litig.*, 482 F. Supp. 2d 365, 380 (S.D.N.Y. 2007) (dismissing claims based on forward-looking statements that were identified as such and were accompanied by meaningful cautionary language).
[36] *See* 15 U.S.C. § 78u5(c)(1)(B); *In re XM Satellite Radio Holdings Sec. Litig.*, 479 F. Supp. 2d 165, 177 (D.D.C. 2007) (stating that, under the PSLRA's second safe harbor, a defendant's forward-looking statement is shielded from liability "if plaintiffs fail to prove that the statement was made with 'actual knowledge' that it was 'false or misleading' ").
[37] *See XM*, 479 F. Supp. 2d at 177.
[38] 544 U.S. 336 (2005).
[39] *Id.* at 346-47 (allegations that plaintiffs "paid artificially inflated prices" for defendant's stock and "suffered damages" when the stock price declined are insufficient to plead loss causation because they fail to identify "what the causal connection might be between that loss and the misrepresentation").
[40] *Id.* at 34243. *See Lentell*, 396 F.3d at 174 (" '[W]hen the plaintiff's loss coincides with a marketwide phenomenon causing comparable losses to other investors, the prospect that the plaintiff's loss was caused by the fraud decreases,' and a plaintiff's claim fails when 'it has not adequately ple[ ]d facts which, if proven, would show that its loss was caused by the alleged misstatements as opposed to intervening events.' " (quoting *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 772 (2d Cir. 1994))).
[41] *Securities Class Action Filings*, *supra* note 1, at 3.

Steps Financial Institutions Should Take

In light of the substantial increase in the number of securities fraud class actions filed against banks in 2008, directors and officers of financial institutions should exercise significant caution when issuing public statements regarding their operations. This is a good time for financial institutions to reevaluate the processes that they employ to (i) reach disclosure decisions and (ii) identify information that would be or could reasonably be perceived as being material to the public's investment decisions. Most important is the process employed by financial institutions to ensure that they are not institutionally aware of any material facts that are contrary to their public statements. Similarly, any forward-looking statements should be identified as such and accompanied by specific, tailored, and meaningful cautionary language warning investors of any known or anticipated risks. Although financial institutions would be prudent to follow these steps under any circumstances, doing so is essential in the current financial climate.

A Word About Director and Officer Liability

As veterans of past financial crises will recall, the FDIC, Federal Savings and Loan Insurance Corporation, and Resolution Trust Corporation played prominent roles in the allocation of responsibility after banks failed in the several financial crises over the last 30 years. When the FDIC is appointed as a receiver by the principal federal bank regulator, it steps into the shoes of the failed bank and takes possession of the bank's assets, including any claims that the bank may have against directors and officers, other employees, service providers, holding companies, shareholders, and professionals, such as accountants and attorneys. In undertaking such investigations, the FDIC's professional liability attorneys and investigators evaluate the bank's potential claims and pursue them as appropriate. Directors and officers are often the prime targets of these suits.

While the process of financial retribution has not yet picked up much speed in the current crisis, it soon will. The FDIC likely will sue parties it views as responsible for bank failures based on theories of negligence and/or fraud. In the most egregious cases, criminal referrals may be made to the Justice Department, and criminal investigations and grand juries could follow. As these cycles go, such regulatory and criminal proceedings likely will be in the next wave of financial institution litigation.

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