7. Credit Loss Liability of Bank Director

2. Arsenal-SSP Ltd (below: Arsenal) is a company founded on the basis of a special legislation to administer the assets and credits of the savings banks that fell in public possession due to the banking crisis in Finland in the early 90's.

Arsenal had raised several damages actions against directors and board of directors members of late savings banks for the credit losses they are alleged to have caused to the banks by negligent credit giving to insolvent clients.

There is by now one Supreme Court decision on Arsenal claims against bank officials, viz. in the case of Mäntsälän Säästöpankki (KKO 1999:12). In that case the local court accepted the claims against the sued two managing directors and some of the sued board members, but adjusted the liabilities. The Court of Appeal, in its turn, rejected all claims. Again, the Supreme Court took the same principal view as the local court, but made alterations to the result of its decision. Now you can consider the facts and legal reasoning of the case.

The managing director and the board members were granted exemption from liability by the meeting of the trustees. The credit losses, but perhaps not all the relevant facts - due to factors of business secrecy - were disclosed in annual reports and other material given to the latter body. An adequate apprehension of the crediting of client clusters and the risks assumed therein may not have been possible to acquire on the basis of the material given. Some managers, however, had obtained the relevant information on their own initiative.

The relevant legal provisions (in the Act on Savings Banks) in the case were mainly the following. (a) Any credit given to a client by a savings bank should as a rule be accompanied by a sufficient security. (b) Giving credit to the same person or the same cluster of clients may not exceed an upper limit of 10 per cent of the bank's own capital, imposed by the supervising authority to the bank. (c) Giving credit to the same cluster of clients may not amount to a volume that would endanger the solvency of the bank.

There were several occasions under court consideration in which the bank had granted credit to an overindebted customer, a construction undertaking, for completing a building project. In these cases the firm, however, became bankrupt, mainly because of the difficulty to predict the depth and long duration of the economic depression which caused a collapse in real estate prices. The products were no longer marketable, and also their values as securities were ruined.

A bank director is in a very difficult situation when considering further credit granting to overindebted customers. The alternatives may be the following: close the credit faucet immediately and let the firm go into bankruptcy and accept the realization of credit risks, or continue credit giving and accept the risk of increased credit losses with a (slight) hope of the recovery of the firm in the future. However, in building project crediting, a rational policy of the bank e.g. with respect to attending the securities, may often consist of trying to prevent the project from remaining incomplete, because of the poor marketability of such a project and high completion costs accruing from the use of another contractor.

Liability for damages requires three preconditions to be fulfilled: (a) existence of a damage, (b) a causal relationship between the acts of the responsible person and the damage, and (c) as a rule negligence of that person. Each one of these preconditions must be considered thoroughly even in this case. E.g. what is the significance of the alleged breaches of relevant norms? Does it matter in

this respect that in many points the bank had followed a common practice that was also accepted by a supervising authority (The Savings Banks Supervision). And what if the above mentioned business economics considerations are in favor of departing from provisions on e.g. sufficient securities? Is mere departing from norms a sufficient condition for establishing liability?