FDIC
Federal Deposit Insurance Corporation
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February 18, 2014

MEMORANDUM TO: Board of Directors

THROUGH: Richard J. Osterman, Jr [redacted]
Acting General Counsel

FROM: Melanie D. Coates [redacted]
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Professional Liability and Financial Crimes Section

SUBJECT: Professional Liability Program Annual Report for 2013

This is a report by the Professional Liability Unit ("PLU") of the Legal Division on the results of the FDIC's professional liability program for 2013. It includes a review of PLU's workload and staffing at year-end.

The purpose of the professional liability program is to hold accountable directors, officers, and professionals who cause losses to insured financial institutions that later fail and are placed in FDIC receivership. The program's existence also enhances industry awareness of sound corporate governance standards. On behalf of the FDIC in its receivership capacity, PLU and the Investigations Department of the Division of Resolutions and Receiverships ("DRR") conduct an investigation of every financial institution failure and pursue professional liability claims that are both meritorious and expected to be cost-effective. PLU also refers appropriate cases to the primary financial regulator for administrative enforcement action. In addition, PLU assists DRR and the Legal Division's Financial Crimes Unit to obtain criminal restitution on behalf of the FDIC as Receiver from defendants who have been convicted of banking crimes that caused losses to financial institutions that later fail and are placed in FDIC receivership.

Recoveries and Expenses

During 2013 PLU and DRR recovered $674,189,266 from, and incurred $144,623,923 in expenses for, all professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries – 2013	
Residential Mortgage-Backed Securities ("RMBS")	$556,009,799	(82.47%)
Director and Officer ("D&O") Liability	$76,098,347	(11.28%)
Accountant Malpractice	$17,384,720	(2.58%)
Mortgage Malpractice or Fraud ("MMF")	$13,365,237	(1.98%)
Fidelity Bond	$7,219,060	(1.07%)
Attorney Malpractice	$1,652,091	(0.25%)
Appraiser Malpractice	$870,000	(0.13%)
Other	$1,590,012	(0.24%)
TOTAL	**$674,189,266**	**(100.00%)**

The $556,009,799 recovered from RMBS claims was obtained principally from two settlements. The FDIC as Receiver for six failed banks received a $500 million payment in December as part of an overall $13 billion settlement of claims by a number of federal and state agencies led by the United States Department of Justice ("DOJ") against JPMorgan Chase & Company and its affiliates ("JPMorgan"). The FDIC's claims were based on violations of federal and state securities laws in connection with the sale of 40 RMBS to Strategic Capital Bank ("Strategic"), Champaign, Illinois, and Citizens National Bank ("Citizens"), Macomb, Illinois, sister banks, which both failed on May 22, 2009; Colonial Bank ("Colonial"), Montgomery, Alabama, which failed on August 14, 2009; Guaranty Bank ("Guaranty"), Austin, Texas, which failed on August 21, 2009; Irwin Union Bank and Trust Company ("Irwin"), Columbus, Indiana, which failed on September 18, 2009; and United Western Bank ("UWB"), Denver, Colorado, which failed on January 21, 2011.[1] As part of the settlement, JPMorgan agreed to waive all claims for indemnification from the FDIC in either its corporate capacity or its capacity as Receiver for Washington Mutual Bank ("WaMu"), Henderson, Nevada, based on any part of JPMorgan's $13 billion settlement. The FDIC's settlement with JPMorgan resolved claims against JPMorgan asserted in ten lawsuits filed from May 2012 to September 2012 as well as additional RMBS claims that the FDIC Board of Directors had authorized but on which the FDIC as Receiver had not yet filed suit. In addition, on October 31 the FDIC as Receiver for four failed banks received payment of a $55,308,631 settlement of claims asserted in four lawsuits against Ally Securities LLC ("Ally Securities") for violations of state and federal securities laws based on misrepresentations and omissions in the offering materials for eight RMBS purchased by Strategic, Citizens, Colonial, and Guaranty. The settlement with JPMorgan fully resolved the Receiver's claims in two lawsuits arising out of Irwin. PLU is continuing to pursue claims in 17 remaining RMBS lawsuits against other defendants.

Of the D&O liability recoveries, the single largest recovery was $9,089,955 received from a settlement with seven former officers and directors of Horizon Bank ("Horizon"), Bellingham, Washington, which failed on January 8, 2010, with $1.19 billion in assets. The Receiver's claims were based on $40.995 million in loan losses caused by the defendants' negligence, gross negligence, and breaches of fiduciary duties in approving 18 loans in violation of Horizon's loan policy and prudent lending standards.

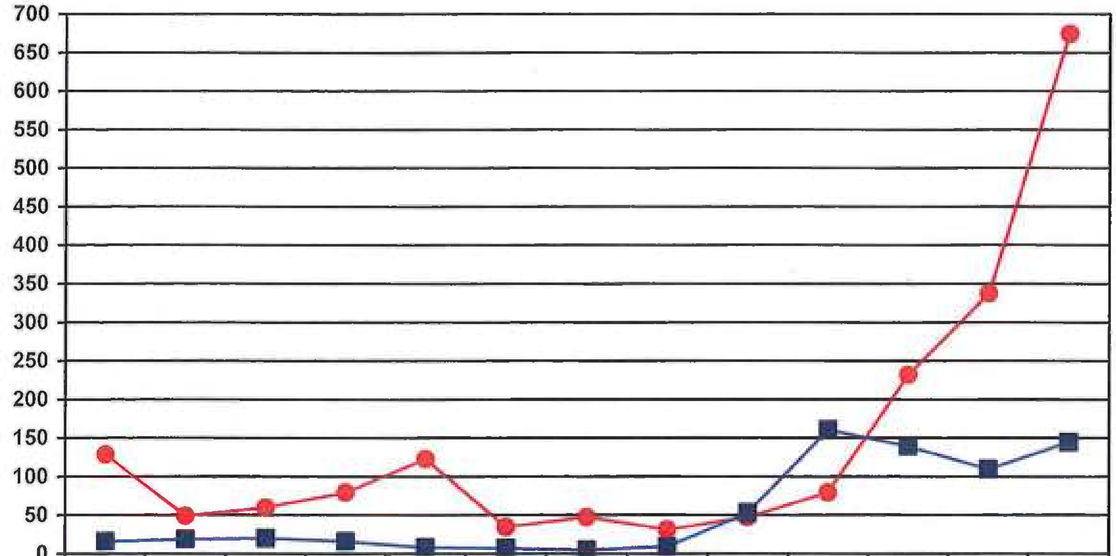
[1] The settlement with JPMorgan nominally totaled $515.4 million. Because DOJ arranged for the FDIC's settlement funds to be remitted to DOJ first, DOJ deducted a three percent ($15.4 million) administrative fee before remitting the agreed-upon net payment of $500 million to the FDIC.

The recovery of $17,384,720 from accountant claims included a $15,234,720 payment received on May 29 in settlement of the Receiver's accountant malpractice claims against Deloitte & Touche, LLP ("Deloitte"), the former external auditor of WaMu. The Receiver's claims arose from Deloitte's issuance of unqualified opinions on WaMu's 2005 and 2006 financial statements.

Of the total program expenses of $144,623,923 incurred during 2013, $107,699,472 (74.47 percent) was incurred by the Legal Division, $36,772,242 (25.43 percent) was incurred by DRR, and $152,209 (0.11 percent) was incurred by other FDIC Divisions and Offices. Legal Division expenses comprise $94,192,960 paid to outside counsel and consultants and $13,506,512 for other expenses (primarily salaries and travel expenses for in-house PLU employees). DRR expenses comprise $23,449,121 paid to outside contractors and $13,323,121 for in-house staff. The ratio of total recoveries to total expenses is 4.66 to 1, and the ratio of recoveries to outside counsel and consultant expenses is 7.16 to 1. These ratios are higher than they were for 2012, when the program recovered $337,332,160, incurred expenses totaling $110,149,337, the ratio of recoveries to total expenses was 3.06 to 1, and the ratio of recoveries to outside counsel and consultant expenses was 4.96 to 1.

Professional liability program expenses during 2013 are attributable primarily to the substantial receivership funding expenses that the Legal Division and DRR are continuing to incur to conduct investigations and to pursue professional liability litigation arising out of the significant increase in the number of insured financial institutions that have failed since the beginning of 2008. Program recoveries tend to lag program expenses incurred to obtain the recoveries by several years. Staff typically spends substantial time and money to build a case before a settlement is reached or a judgment is obtained. Since PLU investigates potential professional liability claims for all failed financial institutions, program expenses include these "sunk" investigation costs even if, as is generally the case, no recoveries result from most investigations. For those failed institutions out of which viable claims are identified, recoveries typically are not obtained until years after the investigation costs have been incurred. In addition, program recoveries not only include settlements reached and judgments obtained in the current reporting period but they also include collections from structured settlements reached in previous years. As a result, most of the expenses incurred during 2013 will not yield recoveries until later years. Concomitantly, much of the recoveries obtained during 2013 actually are the result of expenses incurred in prior years. For all of these reasons, the cost-effectiveness of the program is best measured by comparing recoveries and expenses over many years rather than in any individual year.

FDIC Professional Liability Recoveries and Expenses, 2001-2013 (in $millions)



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Recoveries	128.6	49.1	59.9	79	122.2	34.5	47.1	31.3	47.1	79.4	231.9	337.3	674.2
Expenses	16	19.1	20.2	16.2	8.5	7.2	5	9.7	52.9	160.8	139.5	110.1	144.6

As shown in the attached historical table, from 1986 through 2013 the professional liability program has achieved an overall recoveries-to-expense ratio of 3.69 to 1.

Interim Report on Total Recoveries and Expenses During the Recent Crisis To Date

Since the beginning of 2007, PLU and DRR have recovered $1.448 billion and incurred expenses totaling $622.6 million for all professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Total Recoveries – 2007-2013
Director and Officer ("D&O") Liability	$640,890,446 (44.25%)
Residential Mortgage-Backed Securities ("RMBS")	$556,501,763 (38.42%)
Mortgage Malpractice or Fraud ("MMF")	$109,810,298 (7.58%)
Fidelity Bond	$54,209,233 (3.74%)
Accountant Malpractice	$41,454,317 (2.86%)
Attorney Malpractice	$15,894,157 (1.10%)
Appraiser Malpractice	$870,000 (0.06%)
Other	$28,742,996 (1.99%)
TOTAL	**$1,448,373,230 (100.00%)**

The foregoing table reflects the relative importance of RMBS and residential MMF recoveries from claims filed out of the recent crisis to date relative to claims during the prior crisis (1982-1994). During the prior crisis, PLU and DRR had no RMBS or residential MMF claims or recoveries. In the earlier crisis, as in the more recent crisis (to date), D&O claims were the largest source of recoveries.

Other Significant Developments During 2013

During 2013 PLU obtained authority from the Board of Directors to sue 316 D&O defendants out of 42 failed institutions. In addition, the FDIC authorized 10 other lawsuits for fidelity bond, insurance, attorney malpractice, appraiser malpractice, accounting malpractice, and RMBS claims. While some of these authorized cases resulted in the filing of lawsuits, in others PLU is actively engaging in settlement negotiations and has not yet filed suit.

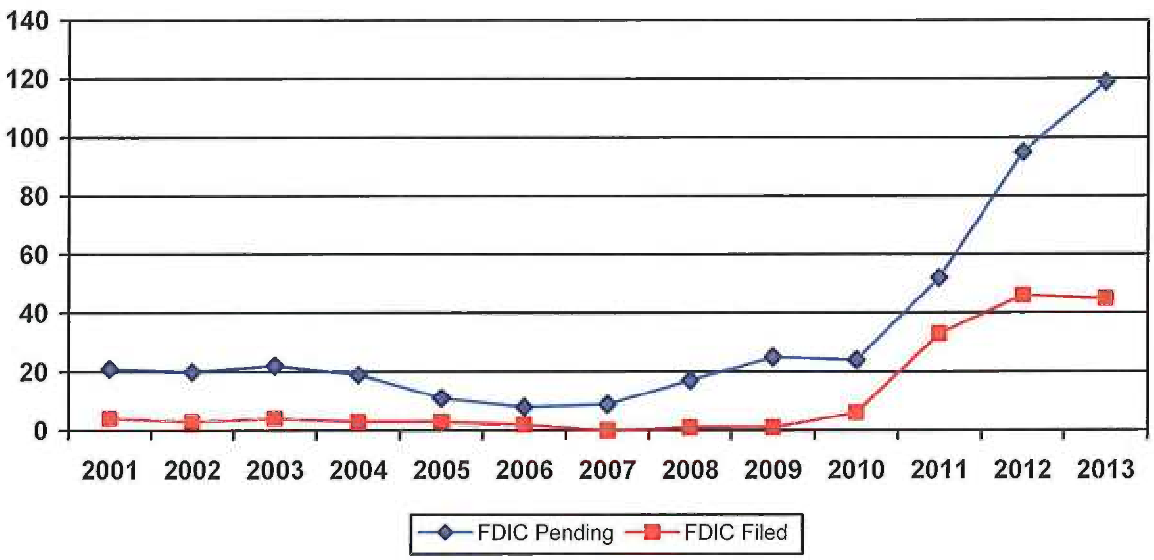
In May the FDIC as Receiver for First Priority Bank ("First Priority"), Bradenton, Florida, tried to a favorable jury verdict its attorney malpractice and breach of fiduciary duty claims against the law firm of Icard, Merrill, Cullis, Timm, Furen &Ginsburg, P.A., and attorney Robert E. Messick. The claims arose out of a $5.3 million acquisition loan that the defendants closed for First Priority in March 2006 without delivering a required assignment of an option to purchase an adjoining land parcel. On May 22, after a seven-day trial, the jury found the defendants liable to the FDIC for $1,149,051. Defendants' appeal of the verdict is pending before the United States Court of Appeals for the Eleventh Circuit. The Board authorized this lawsuit on May 10, 2011, and the FDIC filed its complaint on December 23, 2011. First Priority failed on August 1, 2008, with $258.6 million in assets.

During 2013 PLU also obtained authority from the Board to pursue claims based on the purchase of residential mortgage-backed securities ("RMBS") by UWB. With the filing of this lawsuit out of UWB in January 2014, the FDIC as Receiver currently is pursuing 17 RMBS lawsuits arising out of the following seven receiverships: Franklin, S.S.B. ("Franklin"), Houston, Texas, which failed on November 7, 2008 (2 cases); Security Savings Bank ("Security"), Henderson, Nevada, which failed on February 27, 2009 (2 cases); Strategic and Citizens (3 cases); Colonial (5 cases); Guaranty (3 cases); and UWB (2 cases). In addition to the settlements discussed previously, notable developments during the year in the RMBS cases include a ruling in the consolidated Franklin cases pending in Texas state court denying defendants' motion to dismiss the consolidated case and setting the case for trial in November 2014. In the coordinated proceedings in the Countrywide Multidistrict Litigation ("MDL") in the United States District Court for the Central District of California, the MDL court dismissed several cases and claims out of Strategic, Guaranty, Colonial, and Security based on statute of limitations grounds. To date, in total, the MDL court has dismissed five lawsuits out of four receiverships. The FDIC as Receiver has appealed each of these to the United States Court of Appeals for the Ninth Circuit.

In 2013, D&O liability insurance companies, including Progressive Casualty Insurance Company ("Progressive"), Travelers Indemnity Company ("Travelers"), and BancInsure, Inc., continued to assert that FDIC D&O liability claims are not covered by their insurance policies in a total of 25 cases. Although the terms of the insurance policies at issue vary somewhat, all of these lawsuits most commonly seek declarations relating to whether the insured v. insured exclusion and a carveout from the definition of "Loss" for unpaid loans preclude coverage for claims by the FDIC as Receiver. In January 2013 one judge from the United States District Court for the Northern District of Georgia denied a summary judgment motion by Progressive as premature and also found that the insured v. insured exclusion and the unpaid loan carveout are both ambiguous as applied to D&O claims by the FDIC acting as Receiver. In August 2013 a different federal judge from the same court granted summary judgment to Travelers based on the insured v. insured exclusion (but at the same time ruled for the FDIC on the unpaid loan carveout). In September 2013 the FDIC and the defendants in the underlying merits case appealed this unfavorable decision to the United States Court of Appeals for the Eleventh Circuit.

In 2013 PLU filed 45 lawsuits (excluding MMF lawsuits). As of December 31, 2013, 119 pending professional liability lawsuits (other than MMF lawsuits) were pending. The following graph shows professional liability civil cases from 2001 through year-end 2013, both filed and pending. ("Pending" actions include claims filed by PLU along with claims filed by institutions before they failed that the FDIC inherited as Receiver.)

FDIC Professional Liability Civil Actions, 2001-2013
(Excludes MMF and related-to-PL matters such as individual bankruptcy cases)



In addition, PLU had 83 active MMF lawsuits pending at the end of 2013. These arise out of 11 failed institutions but primarily out of AmTrust Bank, Cleveland, Ohio, which failed on December 4, 2009 (46); BankUnited, FSB ("BankUnited"), Coral Gables, Florida, which failed on May 21, 2009 (13); IndyMac Bank, Pasadena, California, which failed on July 11, 2008 (6); Colonial (5); and WaMu (4). The remaining 9 MMF lawsuits are associated with 6 other failed institutions around the country. PLU also has more than 1,800 additional residential MMF loans in investigation. PLU staff obtained approval from delegated authority during 2013 to file 3 MMF cases and to settle 53 others.

During the year, PLU collected a total of $13,365,237 from residential MMF claims. Not included in these 2013 recoveries is the judgment amount entered in favor of the FDIC as Receiver for BankUnited on October 7 after a three-day bench trial in an MMF case in the United States District Court for the Southern District of Florida. In this case, judgment was entered against First American Title Insurance Company ("First American") in favor of the FDIC as Receiver for the full amount of claimed damages of $507,971 inclusive of prejudgment interest. The lawsuit arose from First American's refusal to pay claims under two closing protection letters ("CPLs") pursuant to which First American promised to indemnify BankUnited for any losses arising out of the dishonest conduct of a closing agent in connection with two mortgage loans. The court found that the closing agent had failed to follow the Bank's closing instructions and had acted dishonestly when the agent had falsely certified that a borrower had made a down payment to purchase the property. First American has appealed the judgment to the United States Court of Appeals for the Eleventh Circuit.

PLU Workload and Staffing at Year-End

During 2013, 24 FDIC-insured financial institutions failed, 10 of which were headquartered in three states, Florida (4), Arizona (3), Georgia (3). The largest institution to fail was First National Bank, Edinburgh, Texas, which failed on September 13, 2013, with $3.09 billion in assets. These 24 failures brought total institution failures since the beginning of 2007 to 492.

These 492 failures on average also were relatively large in size, since their assets at failure totaled $688.9 billion. While these 492 failed institutions constitute only 21.02 percent of the total number of 2,341 institutions that failed during the previous failing bank and thrift crisis spanning 13 years from 1982 to 1994, the total assets of $688.9 billion associated with these 492 failed institutions are 104.84 percent of the $657.09 billion in total assets associated with the 2,341 failures from the prior crisis.[2]

Given their large average size and greater complexity, these 492 failures in the past seven years have resulted in a very substantial increase in PLU's workload since 2007. Even though the rate of institution failures continued to decline in 2013, PLU's overall workload, as measured by five workload drivers and accounting in particular for the significantly greater work required to manage its growing litigation caseload, remained elevated and was still very heavy during 2013. However, the nature of PLU's workload also is changing – litigated cases make up an increasingly larger part of PLU's workload while investigations make up a slowly decreasing part. For each institution that fails, PLU opens 11 different types of investigations, although most are soon closed once it becomes clear that no viable claims exist.[3] As of September 1, 2007, PLU had 49 open institutions in its inventory (39 of which were open solely for the limited purpose of monitoring collections from judgments and structured settlements), 8 professional liability lawsuits, 3 related lawsuits, 0 MMF lawsuits, 12 open investigations, and 95 active

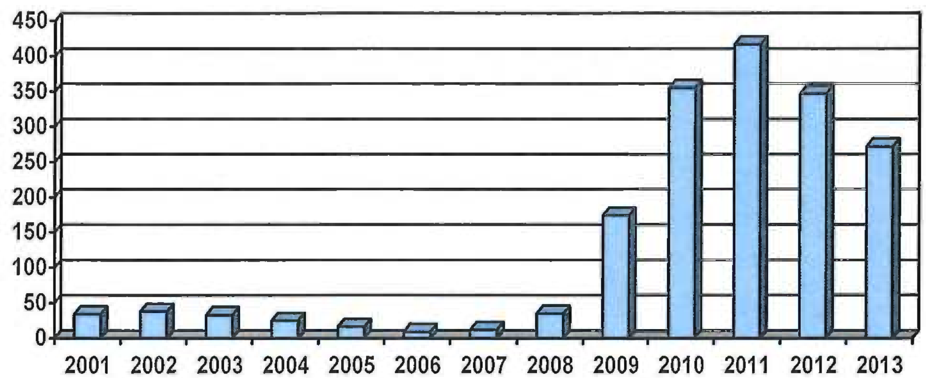
[2] The average asset size of these 492 failed institutions is $1.40 billion. Even excluding WaMu, which failed in 2008 with $307 billion in assets, the average asset size of the 491 remaining failed institutions is $777.88 million – still nearly three times the average $281 million asset size of the 2,341 institutions that failed during the 1982-1994 crisis.

The data in this memorandum on numbers of failed institutions and associated assets have been reviewed and approved by the FDIC's Division of Insurance and Research.

[3] The 11 types of investigations are: (1) D&O, (2) fidelity bond, (3) MMF, (4) attorney, (5) accountant, (6) appraiser, (7) RMBS and other securities, (8) commodities, (9) insurance, (10) insurance issuer, and (11) other. Some institutions have multiple matters open. For example, a single bank may have a pending D&O lawsuit, an active RMBS investigation, and a pending attorney malpractice lawsuit.

collection matters.[4] As of year-end 2013, PLU had 317 open institutions, 119 pending professional liability lawsuits, 18 additional related lawsuits, 83 MMF lawsuits, 796 open investigations,[5] and 136 active collection matters.

Institutions With Open Investigations or Lawsuits at Year-End
(Institutions open only for collection are not included)



To handle its substantially increasing workload, PLU began increasing its staff significantly starting in the second half of 2008. From a single office in Virginia Square that had 13 total staff including 2 managers in mid-2008, PLU, as of year-end 2013, had 56 total staff including 8 managers and 38 attorneys in three offices – Virginia Square; the East Coast Temporary Satellite Office in Jacksonville, Florida; and the Dallas Regional Office in Dallas, Texas. PLU's staff of 56 is temporarily down by 8 due to unexpected departures of term attorneys and support staff. PLU is in the process of hiring additional attorneys and support staff to replace some of these recently departed employees.

Conclusion

During 2013 the FDIC's professional liability program operated cost-effectively recovering a total of $674,189,266 and incurring total expenses of $144,623,923 as PLU and DRR Investigations continued to devote substantial resources to the continuing professional liability investigations and the increasing number of litigated cases arising out of the 492 failures that have occurred since the beginning of 2007 through 2013.

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4 For PLU management purposes, a failed institution is "open" in PLU while PLU is working on any matter relating to that failed institution. All institutions in PLU's inventory are failed institutions.

5 An "open investigation" in PLU's inventory refers to the fact that PLU routinely opens 11 investigations for each failed institution but then "closes" each investigation as it either determines that there is no claim worth pursuing or settles the associated claim. An "open investigation," therefore, is an investigation in PLU's inventory that is still active because it has not been settled or otherwise terminated.

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES ($ MILLIONS)

	Recoveries[1]	In-House PLU Expenses	DRR Investigation Expenses	Outside Counsel Expenses	Total Expenses[2]	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
2013	$674.2	$13.5	$36.8	$94.2	$144.6	7.16 to 1	4.66 to 1
2012	$337.3	$12.6	$29.3	$68.1	$110.1	4.96 to 1	3.06 to 1
2011	$231.9	$12.0	$62.3	$64.7	$139.5	3.58 to 1	1.66 to 1
2010	$79.4	$10.1	$102.5	$47.2	$160.8	1.68 to 1	0.49 to 1
2009	$47.1	$5.2	$35.9	$11.3	$52.9	4.18 to 1	0.89 to 1
2008	$31.3	$2.0	$5.3	$2.4	$9.7	13.1 to 1	3.23 to 1
2007	$47.1	$2.0	$.7	$2.3	$5.0	20.62 to 1	9.40 to 1
2006	$34.5	$2.6	$.9	$3.7	$7.2	9.30 to 1	4.80 to 1
2005	$122.2	$3.4	$1.1	$3.9	$8.5	31.04 to 1	14.38 to 1
2004	$79.0	$4.0	$3.1	$9.0	$16.2	8.79 to 1	4.88 to 1
2003	$59.9	$3.5	$3.0	$13.7	$20.2	4.38 to 1	2.96 to 1
2002	$49.1	$3.2	$2.8	$13.1	$19.1	3.75 to 1	2.57 to 1
2001	$128.6	$3.4	$2.1	$10.5	$16.0	12.25 to 1	8.04 to 1
2000	$54.4	$4.0	$2.7	$14.0	$20.7	3.89 to 1	2.63 to 1
1999	$84.2	$5.8	$3.2	$17.4	$26.4	4.84 to 1	3.19 to 1
1998	$186.5	$5.8	$4.2	$21.9	$31.9	8.52 to 1	5.85 to 1
1997	$156.8	$7.8	$2.3	$29.1	$39.2	5.39 to 1	4.00 to 1
1996	$195.9	$15.8	$4.0	$48.1	$67.9	4.07 to 1	2.89 to 1
1995	$563.9	$14.0	$5.3	$98.1	$117.4	5.68 to 1	4.75 to 1
1994	$909.9	$17.7	$11.2	$135.5	$164.4	6.72 to 1	5.53 to 1
1993	$1,231.2	$18.4	$17.9	$187.3	$223.6	6.57 to 1	5.51 to 1
1992	$972.6	$15.7	$16.6	$179.3	$211.6	5.42 to 1	4.60 to 1
1991	$425.2	$11.7	$7.7	$183.7	$203.1	2.31 to 1	2.09 to 1
1990	$374.3	$6.1	$5.2	$94.8	$106.1	3.95 to 1	3.53 to 1
1989	$152.1	$4.5	$4.5	$32.0	$41.0	4.75 to 1	3.71 to 1
1988	$90.0	$1.4	$3.7	$20.8	$25.9	4.33 to 1	3.47 to 1
1987	$71.5	$1.1	$4.3	$15.2	$20.6	4.70 to 1	3.47 to 1
1986	$83.3	$1.0	$3.0	$10.9	$14.9	7.64 to 1	5.59 to 1
TOTAL	$7,473.40	$208.30	$381.60	$1432.20	$2024.50	5.22 to 1	3.69 to 1

1 Recoveries comprise all FDIC, RTC, and FSLIC recoveries, including RTC and FDIC Drexel-Milken recoveries of $1.143 billion.

2 Expenses include Drexel-Milken expenses of $106.1 million. The following categories of expenses are unavailable and are not included: all FSLIC fees and expenses for 1986-1988; FSLIC in-house (legal and investigation) expenses for 1989; and RTC in-house expenses (1989-1995). DRR investigation expenses (in column 4) for all years before 1998 are staff compensation only (and exclude other direct costs). In-house expenses for all years shown exclude overhead.