



February 15, 2016

MEMORANDUM TO: Board of Directors

THROUGH: Charles Yi
General Counsel

FROM: Floyd I. Robinson
Assistant General Counsel
Professional Liability and Financial Crimes Section

SUBJECT: Professional Liability Program Annual Report for 2015

This is a report by the Professional Liability Unit (“PLU”) of the Legal Division on the results of the professional liability program of the Federal Deposit Insurance Corporation (“FDIC”) for 2015. It includes a review of PLU’s workload and staffing at year-end.

The purpose of the professional liability program is to recover funds for FDIC receiverships and to hold accountable directors, officers, and professionals who caused losses to insured financial institutions that later failed and were 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”) investigate potential professional liability claims arising from every financial institution failure but pursue claims only if they are both meritorious and expected to be cost-effective. Where appropriate, PLU refers cases to the FDIC’s Enforcement Section for administrative enforcement action by the failed institution’s primary financial regulator. In addition, PLU assists DRR and the Legal Division’s Financial Crimes Unit to obtain criminal restitution from defendants convicted of banking crimes that caused losses to financial institutions that later failed and were placed in FDIC receivership.

Recoveries and Expenses

During 2015 PLU and DRR recovered \$450,301,616 and incurred expenses totaling \$96,517,743 for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries – 2015	
Director and Officer (“D&O”) Liability	\$274,921,399	(61.05%)
Securities		
Other	\$49,300,989	(10.95%)
Residential Mortgage-Backed Securities (“RMBS”)	\$27,125,000	(6.02%)
Fidelity Bond	\$53,445,057	(11.87%)
Mortgage Malpractice or Fraud (“MMF”)	\$31,013,842	(6.89%)
Insurance	\$7,263,836	(1.61%)
Accountant Malpractice	\$5,380,000	(1.19%)
Attorney Malpractice	\$875,000	(0.19%)
Appraiser Malpractice	\$824,700	(0.18%)
Other	\$151,793	(0.03%)
TOTAL	\$450,301,616	(100.00%)

Of the 2015 recoveries, \$274,921,399 came from D&O claims, which arose out of 68 receiverships. The single largest D&O recovery was \$34 million received from a settlement with 12 former directors and officers of Westernbank Puerto Rico (“Westernbank”), Mayaguez, Puerto Rico, nine of their spouses, nine related conjugal partnerships, four liability insurance carriers, and three trustees. Westernbank failed on April 30, 2010, with \$10.8 billion in assets. The Westernbank D&O claims were based on gross negligence by all of the former directors and officers and breaches of fiduciary duty by one of the former officers in approving 21 loans resulting in \$176.02 million in losses to Westernbank. Of the remaining D&O recoveries, \$60.3 million came from 13 D&O cases that were settled over the last four months of 2015 as a group with St. Paul Mercury Insurance Company, a Travelers Indemnity Company (“Travelers”).¹

The FDIC recovered \$76,425,989 from two types of securities claims – reverse repurchase (“repo”) agreement claims and RMBS claims. The FDIC received \$48,724,428 in four distributions from repo claims out of Westernbank in the Lehman Brothers, Inc., Chapter 7 bankruptcy proceeding. Additional distributions are expected, but the amounts are not yet known. It received another \$27,125,000 from RMBS claims out of two failed institutions. Most of this – \$24 million – was received from a settlement with Morgan Stanley & Company LLC (“Morgan Stanley”) out of Franklin Bank, S.S.B. (“Franklin”), Houston, Texas, of claims that Morgan Stanley had made material misrepresentations and omissions in securities offering documents for four RMBS that Franklin had purchased. Franklin failed on November 7, 2008, with \$5.1 billion in assets.

The FDIC recovered \$53,445,057 from fidelity bond claims out of ten institutions. The largest single recovery was \$27.1 million from the settlement of a claim against Federal Insurance Company (“Chubb”) under three fidelity bonds providing coverage for Colonial Bank (“Colonial”), Montgomery, Alabama. Colonial failed on August 14, 2009, with \$25.5 billion in assets. The FDIC and the bankruptcy trustee for Colonial’s holding company, Colonial Bancgroup, Inc. (“CBG”), pursued civil claims jointly against Chubb and in 2014 reached a \$30 million settlement with Chubb. The claims under the bonds were based on the dishonest activities of Colonial employees who conspired with Lee Farkas, the Chief Executive Officer of

¹ An additional \$9.7 million from a 14th D&O case settled as part of this group was paid in January 2016.

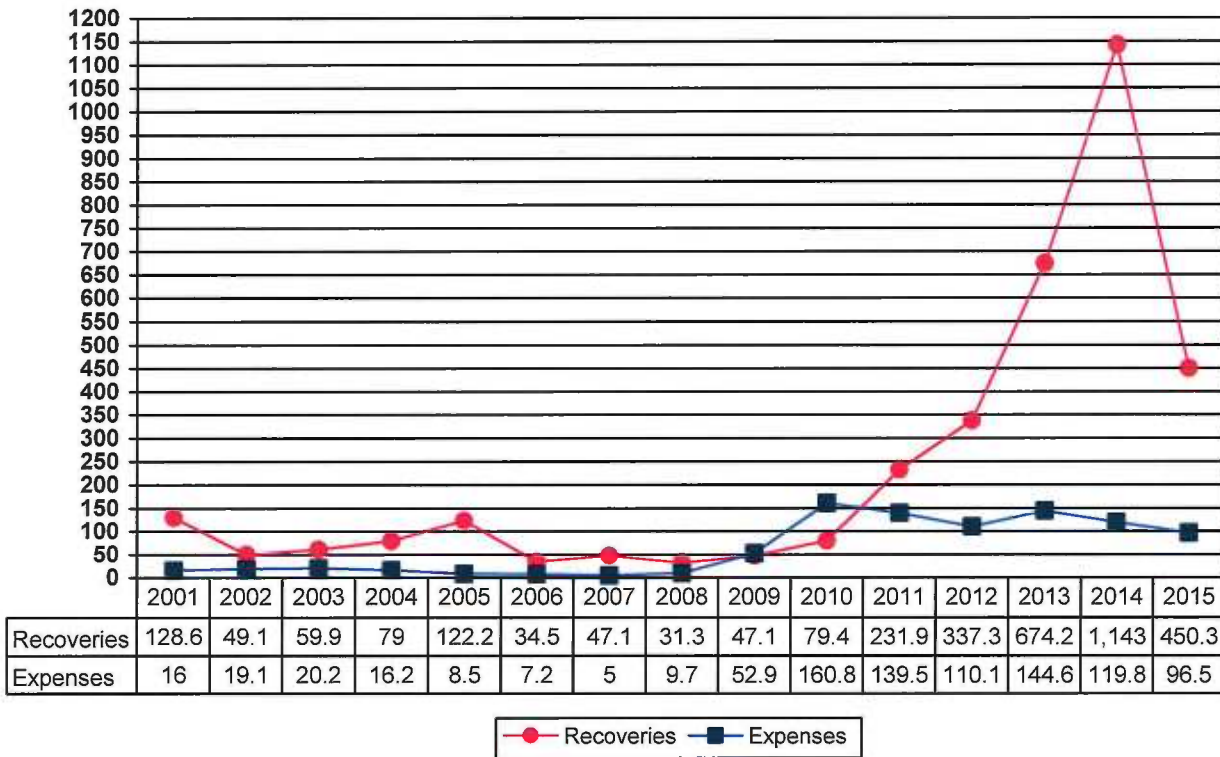
Taylor Bean & Whitaker, to fund thousands of fictitious mortgage loans resulting in losses to Colonial in excess of \$2 billion. The Chubb settlement proceeds were placed into escrow pending the resolution of disputes between CBG and the FDIC over the ownership of the proceeds from the fidelity bonds. In 2015, the FDIC received payment of 90 percent of the Chubb settlement proceeds as part of a global settlement among the FDIC as Receiver for Colonial, CBG, and Branch Banking & Trust, which resolved the bond claim dispute as well as several other non-professional liability claim disputes among the parties.

The FDIC also received \$31 million from MMF claims arising out of 13 institutions. The largest of these was a \$5.75 million settlement of claims against Attorneys' Title Insurance Fund, Inc. ("ATIF") based on ATIF's breach of its closing protection letters in failing to indemnify Washington Mutual Bank ("WaMu"), Henderson, Nevada, for losses incurred from the fraud of ATIF's closing agent in closing 14 residential mortgage loans. WaMu failed on September 25, 2008, with \$307 billion in assets.

Of the total program expenses of \$96,517,743 incurred during 2015, the Legal Division incurred \$85,275,900 (88.35 percent), DRR incurred \$11,190,631 (11.59 percent), and other FDIC Divisions and Offices incurred \$51,212 (0.05 percent). Legal Division expenses comprise \$73,143,927 paid to outside counsel and consultants and \$12,131,973 for other expenses (primarily salaries and travel expenses for in-house PLU employees). DRR expenses comprise \$4,487,451 paid to outside contractors and \$6,703,180 for in-house staff. The ratio of total recoveries to total expenses is 4.67 to 1, and the ratio of recoveries to outside counsel and consultant expenses is 6.16 to 1. These ratios are lower than they were for 2014, when the program recovered \$1,142,727,799, total expenses were \$119,841,727, and the ratio of recoveries to total expenses at that time was 9.54 to 1.

Professional liability program expenses during 2015 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 from the significant increase in the number of failures of insured financial institutions that has occurred since the beginning of 2007. Program recoveries tend to lag program expenses incurred to obtain those 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 typically the case for a failed bank investigation, 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 2015 will not yield recoveries until later years. Concomitantly, much of the recoveries obtained during 2015 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, 2001-2015 (in Smillions)



As shown in the historical table attached at the end of this report, from 1986 through 2015 the professional liability program has achieved an overall recoveries-to-expenses ratio of 4.05 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 \$3.041 billion and incurred expenses totaling \$838.9 million for all professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Total Recoveries – 2007-2015
Securities	
RMBS	\$1,422,384,292 (46.77%)
Other	\$49,300,989 (1.62%)
D&O Liability	\$1,126,005,812 (37.02%)
MMF	\$156,045,640 (5.13%)
Fidelity Bond	\$125,366,643 (4.12%)
Accountant Malpractice	\$46,834,317 (1.54%)
Appraiser Malpractice	\$44,775,632 (1.47%)
Other	\$34,156,336 (1.12%)
Attorney Malpractice	\$29,269,157 (0.96%)
Insurance	\$7,263,836 (0.24%)
TOTAL	\$3,041,402,654 (100.00%)

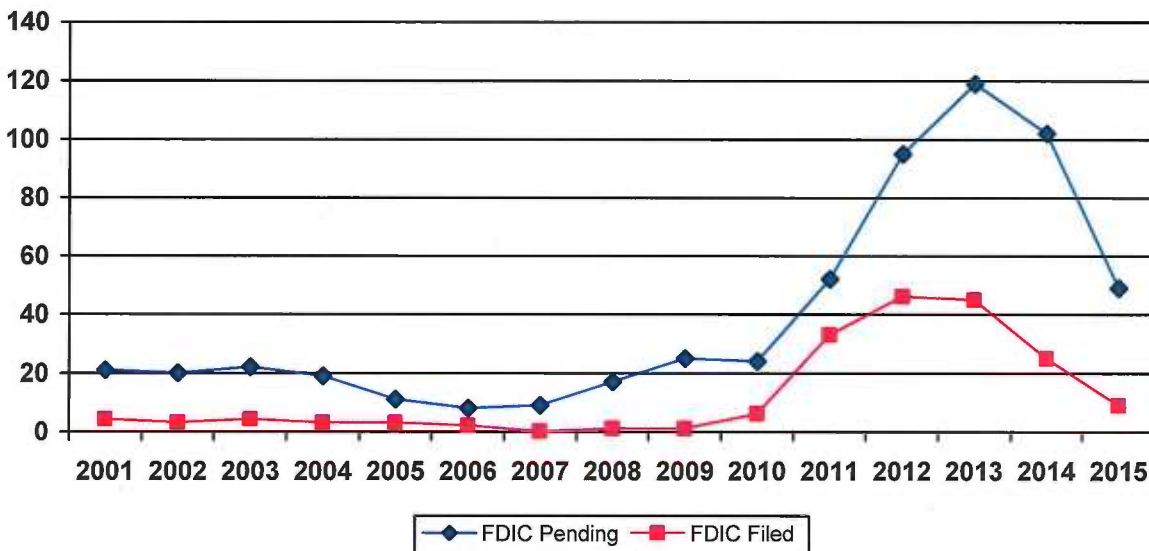
Authorized and Pending Lawsuits

During 2015 PLU obtained authority from the Board of Directors to sue 26 D&O defendants out of two failed institutions. The larger of these arose from the failure of Montgomery Bank & Trust (“MBT”), Ailey, Georgia. The claims arise out of the directors’ and officers’ negligence, gross negligence, and breaches of fiduciary duties in connection with the misappropriation of funds by an MBT former director. PLU filed suit against the directors and officers on July 1, 2015, in the United States District Court for the Southern District of Georgia. MBT failed on July 6, 2012, with \$153.2 million in assets.

In addition, the FDIC authorized nine other lawsuits for securities, RMBS trustee, and fidelity bond claims, and it authorized 65 MMF lawsuits. While some of these authorized lawsuits resulted in the filing of cases, in others PLU is actively engaging in settlement negotiations and has not yet filed suit.

As of year-end 2015, a total of 49 professional liability lawsuits other than MMF lawsuits were pending. The following graph shows pending professional liability civil cases (other than MMF lawsuits) from 2001 through year-end 2015. (“Pending” actions include claims that PLU filed as well as claims that institutions filed before they failed, which the FDIC inherited as Receiver.)

FDIC Professional Liability Civil Actions, 2001-2015
(Excludes MMF and related-to-PL matters such as individual bankruptcy cases)



PLU also had 87 active MMF lawsuits pending at the end of 2015. These arise out of 7 failed institutions but primarily from AmTrust Bank, Cleveland, Ohio, which failed on December 4, 2009 (46); BankUnited, FSB (“BankUnited”), Coral Gables, Florida, which failed on May 21, 2009 (22); IndyMac Bank, Pasadena, California, which failed on July 11, 2008 (9); and WaMu (4). The remaining six MMF lawsuits are associated with three other failed institutions around the country. During the year, PLU staff obtained approval to settle 16 MMF cases.

Significant Case Developments During 2015

On August 4 the United States District Court for the Southern District of New York ruled on motions to dismiss certain claims filed by direct action plaintiffs, including the FDIC as Receiver for 38 failed banks, in the multi-district litigation of claims based on suppression of the U.S. Dollar (“USD”) London Interbank Offered Rate (“LIBOR”). The FDIC’s claims, against 31 banks and bank affiliates and three British Bankers’ Association (“BBA”) entities, are based on various state tort and contract law theories and federal and state antitrust laws. The FDIC alleges that the defendants’ suppression of USD LIBOR caused the 38 failed banks to receive smaller payments on loans and other assets linked to USD LIBOR than they otherwise would have received. The court denied the motions to dismiss most of the FDIC’s contract, tort, and fraud claims. However, the court dismissed some of the FDIC’s claims against certain defendants as time-barred and dismissed all of the plaintiffs’ antitrust claims. The court also held that, absent a contract among the parties, it lacks personal jurisdiction over the BBA entities and any other defendant that did not determine or submit its LIBOR rates in New York. Staff is evaluating the FDIC’s options for pursuing the dismissed claims against the foreign defendants in other courts.

During 2015 the FDIC as Receiver continued to litigate 15 RMBS lawsuits arising out of the following seven receiverships: Franklin (1 case); Security Savings Bank, Henderson, Nevada, which failed on February 27, 2009 (1 case); Strategic Capital Bank, Champaign, Illinois, and Citizens National Bank, Macomb, Illinois, sister banks, which both failed on May 22, 2009 (2 cases); Colonial (5 cases); Guaranty Bank (“Guaranty”), Austin, Texas, which failed on August 21, 2009 (3 cases); and United Western Bank (“UWB”), Denver, Colorado, which failed on January 21, 2011 (3 cases). In the lawsuits, the FDIC has sued sellers and underwriters of RMBS asserting that the defendants violated state and federal securities laws by making material misrepresentations and omissions in the offering documents and misleading investors about the riskiness of the RMBS. Two of the lawsuits settled in their entirety in 2015. Nine of the lawsuits were on appeal to the United States Courts of Appeals for the Second Circuit, the Fifth Circuit, and the Ninth Circuit. The appeals in all three circuits progressed during the year, with briefing completed and oral arguments held on July 8, October 8, and December 8 in the Fifth Circuit, Second Circuit, and Ninth Circuit, respectively. On August 10 the Fifth Circuit issued a favorable decision reversing the two district court judgments that had dismissed two of the lawsuits out of Guaranty on statute of limitations grounds. The Second Circuit and Ninth Circuit have not yet issued their decisions.

As part of efforts by the United States District Court for the Central District of California to wind down the Countywide RMBS multidistrict litigation, the court transferred two FDIC RMBS cases, one case out of UWB and one case out of Colonial, that had been pending in that court back to their home states for further proceedings. The UWB case was transferred to the United States District Court for Colorado on April 13, 2015, where the parties reached a settlement in December. The Colonial case was transferred to the United States District Court for the Middle District of Alabama on June 4, 2015, where it has been set for trial on October 24, 2016. Two other Colonial cases pending in Alabama state court are set for trials beginning on or after February 2017.

During 2015 D&O liability insurance carriers continued to assert coverage defenses to FDIC D&O claims in 23 cases. In these lawsuits, the carriers most often seek declarations that the insured v. insured exclusion and a carve-out from the definition of “Loss” for unpaid loans preclude coverage for FDIC claims. In January and February, courts issued two insurance coverage rulings favorable to the FDIC. One of the cases settled shortly after the January ruling. The second case is scheduled for trial on the insurer’s rescission defense in March 2016. In another case, an appeal to the United States Court of Appeals for the Ninth Circuit by Travelers from an order favorable to the FDIC as Receiver for Pacific Coast National Bank, San Clemente, California, remains pending. In this case, the United States District Court for the Central District of California granted the FDIC summary judgment after finding that neither the insured v. insured exclusion nor the unpaid loan carve-out precludes bars coverage for the FDIC’s claims.

PLU Workload and Staffing at Year-End

During 2015, eight FDIC-insured financial institutions failed, four of which were headquartered in two states, Illinois (2) and Georgia (2). The largest institution to fail was Doral Bank, San Juan, Puerto Rico, which failed on February 27 with \$5.899 billion in assets. These eight failures brought total institution failures since the beginning of 2007 to 518.

These 518 failures on average also were relatively large in size since their assets at failure totaled \$698.73 billion. While these 518 failed institutions constitute only 22.13 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 \$698.73 billion associated with these 518 failed institutions are 106.34 percent of the \$657.09 billion in total assets associated with the 2,341 failures from the prior crisis.²

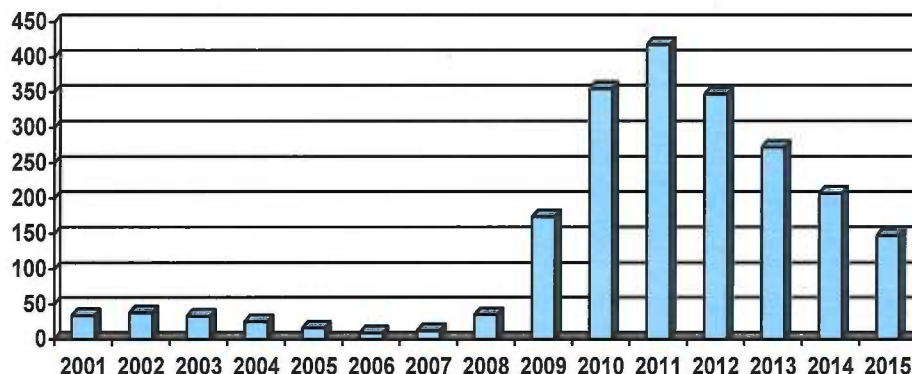
Given their large average size and greater complexity, these 518 failures in the past eight years resulted in a very substantial increase in PLU’s workload beginning in 2008. Even though the rate of institution failures continued to decline in 2015, PLU’s overall workload, as measured by five workload drivers and accounting in particular for the substantial work required to manage its active litigation caseload, was still heavy during 2015. As in 2014, the nature of PLU’s workload in 2015 remained primarily focused on litigated cases, with investigations continuing to make up a decreasing part of its workload. 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

² The average asset size of these 518 failed institutions is \$1.3 billion. Even excluding WaMu, which failed in 2008 with \$307 billion in assets, the average asset size of the 517 remaining failed institutions is \$757.67 million – still nearly three times the average \$281 million asset size of the 2,341 institutions that failed during the 1982-1994 crisis.

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, a pending bond lawsuit, and an active MMF investigation.

open investigations, and 95 active collection matters.⁴ As of year-end 2015, PLU had 181 open institutions, 34 of which are open for collections only, 49 pending professional liability lawsuits, 9 additional related lawsuits, 87 MMF lawsuits, 264 open investigations,⁵ and 67 active collection matters.

Institutions With Open Investigations or Lawsuits at Year-End
(Excludes Institutions Open Only for Collection)



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 17 total staff including 2 managers in January 2008, PLU as of year-end 2011 had grown to 65 staff including managers in five offices – Virginia Square; the East Coast Temporary Satellite Office in Jacksonville, Florida; the Midwest Temporary Satellite Office in Schaumburg, Illinois; the West Coast Temporary Satellite Office in Irvine, California; and the Dallas Regional Office in Dallas, Texas. As of year-end 2015, PLU had 44 total staff in two offices – Virginia Square and the Dallas Regional Office.

Conclusion

During 2015 the FDIC’s professional liability program continued to operate cost-effectively recovering a total of \$450,301,616 and incurring total expenses of \$96,517,743 as PLU and DRR continued to devote substantial resources to the professional liability investigations and litigation cases arising from the 518 failures that have occurred since the beginning of 2007 through 2015.

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 ⁶	In-House PLU Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses ⁷	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
2015	\$450.3	\$12.1	\$11.2	\$73.1	\$96.5	6.16 to 1	4.67 to 1
2014	\$1,142.7	\$13.3	\$16.3	\$90.1	\$119.8	12.68 to 1	9.54 to 1
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	\$9,066.4	\$233.7	\$409.1	\$1595.8	\$2240.8	5.68 to 1	4.05 to 1

⁶ Recoveries comprise all FDIC, RTC, and FSLIC recoveries, including RTC and FDIC Drexel-Milken recoveries of \$1.143 billion.

⁷ Expenses include Drexel-Milken expenses of \$106.1 million. The following categories of expenses are unavailable or are not included: all FSLIC fees and expenses for 1986-1988; FSLIC in-house (legal and investigation) expenses for 1989; RTC in-house expenses (1989-1995), and certain electronic data costs. DRR investigation expenses (shown 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.