FDIC
Federal Deposit Insurance Corporation
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February 19, 2020

MEMORANDUM TO: Board of Directors

THROUGH: Nicholas J. Podsiadly [redacted]
General Counsel

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

SUBJECT: Professional Liability Annual Report for 2019

This is a report by the Professional Liability and Financial Crimes Section ("PLFCS") of the Legal Division on the results of the professional liability program of the Federal Deposit Insurance Corporation ("FDIC") for 2019. It includes a review of workload and staffing of PLFCS 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, PLFCS 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, PLFCS refers cases to the FDIC's Enforcement Section for administrative enforcement action by the failed institution's primary financial regulator. PLFCS also coordinates with DRR 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 2019 PLFCS and DRR recovered $626,448,482 and incurred expenses totaling $27,602,808 for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries – 2019	
Accountant Malpractice	$335,000,000	(53.48%)
Residential Mortgage-Backed Securities ("RMBS")	$260,021,139	(41.51%)
Director and Officer ("D&O") Liability	$19,185,499	(3.06%)
Fidelity Bond	$9,467,500	(1.51%)
Mortgage Malpractice or Mortgage Fraud ("MMF")	$1,574,344	(0.25%)
Attorney Malpractice	$1,200,000	(0.19%)
TOTAL	**$626,448,482**	**(100.00%)**

All of the $335 million in accountant malpractice recoveries came from the settlement of claims out of the receivership of Colonial Bank ("Colonial"), Montgomery, Alabama, against PricewaterhouseCoopers LLP ("PwC"), Colonial's former independent external auditor. The FDIC's claims were based on PwC's malpractice in failing to detect a multi-year fraud perpetrated on Colonial by its largest customer and aided and abetted by two Colonial employees. Colonial failed on August 14, 2009, with $25.45 billion in assets.

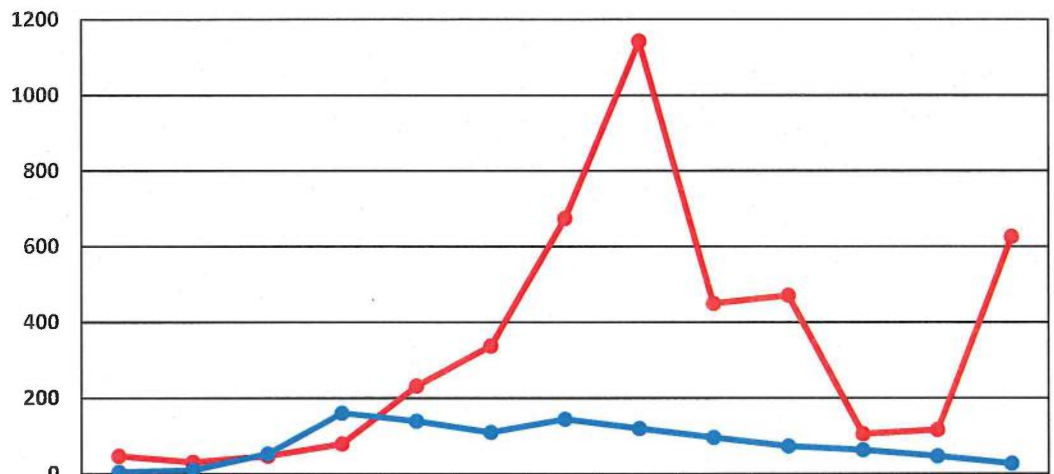
The $260 million in RMBS recoveries resulted from claims out of seven receiverships. The largest of these recoveries resulted from a $150 million settlement of RMBS claims out of Guaranty Bank ("Guaranty"), Austin, Texas, against Deutsche Bank Securities Inc. ("Deutsche"). The FDIC sued Deutsche for violations of the Texas Securities Act in connection with misrepresentations and omissions in the offering documents for three RMBS Guaranty purchased before its failure. Guaranty failed on August 21, 2009, with $13.46 billion in assets.

Of the remaining four types of recoveries, the single largest recovery was $14 million from the settlement of a D&O liability case against nine former directors and officers of Eurobank, San Juan, Puerto Rico. Eurobank failed on April 30, 2010, with $2.45 billion in assets.

Of the total program expenses of $27,602,808 in 2019, the Legal Division incurred $25,717,287 (93.17 percent), DRR incurred $1,883,177 (6.82 percent), and other FDIC Divisions and Offices incurred $2,344 (0.01 percent). Legal Division expenses comprise $18,945,985 paid to outside counsel and consultants and $6,771,302 for other expenses (primarily salaries and travel expenses for in-house PLFCS employees). DRR expenses comprise $2,817 paid to outside contractors and $1,880,360 for in-house staff. The ratio of total recoveries to total expenses is 22.7 to 1, and the ratio of recoveries to outside counsel and consultant expenses only is 33.1 to 1.

Professional liability program expenses during 2019 resulted primarily from receivership funding expenses that the Legal Division and DRR incurred to conduct professional liability investigations and litigation arising from the insured financial institutions that failed since 2008. Typically, program expenses are incurred years before associated recoveries are received, since in most instances staff spends substantial time and money to investigate and develop a claim before a settlement or judgment is obtained. Program expenses also include substantial investigation and legal analysis costs for investigations that do not ultimately identify meritorious and cost-effective claims and that, as a result, produce no recoveries. Investigation expenses for a failed institution include these sunk costs while recoveries from more cost-effective claims from the same institution may not be obtained until many years later. In addition, program recoveries result not only from settlements reached and judgments obtained in the current reporting period but also from collections from structured settlements reached in previous reporting periods. For all of these reasons, the cost-effectiveness of the program is best assessed by comparing recoveries and expenses over many years rather than in any single reporting period.

FDIC Professional Liability Recoveries and Expenses
2007-2019 ($millions)



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Recoveries	47.1	31.3	47.1	79.4	231.9	337.3	674.2	1142.7	450.3	470.9	105.4	116.3	626.4
Expenses	5	9.7	52.9	160.8	139.5	110.1	144.6	119.8	96.5	73.5	63.5	47.3	27.6

As shown in the historical table attached to this report, from 1986 through 2019 the overall recoveries-to-expenses ratio for the professional liability program is 4.2 to 1.

<u>Report on Total Recoveries and Expenses From 2007 Through 2019</u>

To show the relative significance of different types of recoveries, the following table lists recoveries by type from 2007 to date.

Type of Claim	Total Recoveries – 2007-2019	
Securities		
RMBS	$1,969,189,183	(45.16%)
Other	$62,417,540	(1.43%)
D&O Liability	$1,293,740,202	(29.67%)
Accountant Malpractice	$447,885,367	(10.27%)
MMF	$237,275,913	(5.44%)
Fidelity Bond	$203,729,058	(4.67%)
Appraiser Malpractice	$45,738,132	(1.05%)
Attorney Malpractice	$43,624,157	(1.00%)
Other	$34,400,065	(0.79%)
Insurance	$22,478,837	(0.52%)
TOTAL	**4,360,478,454**	**(100.00%)**

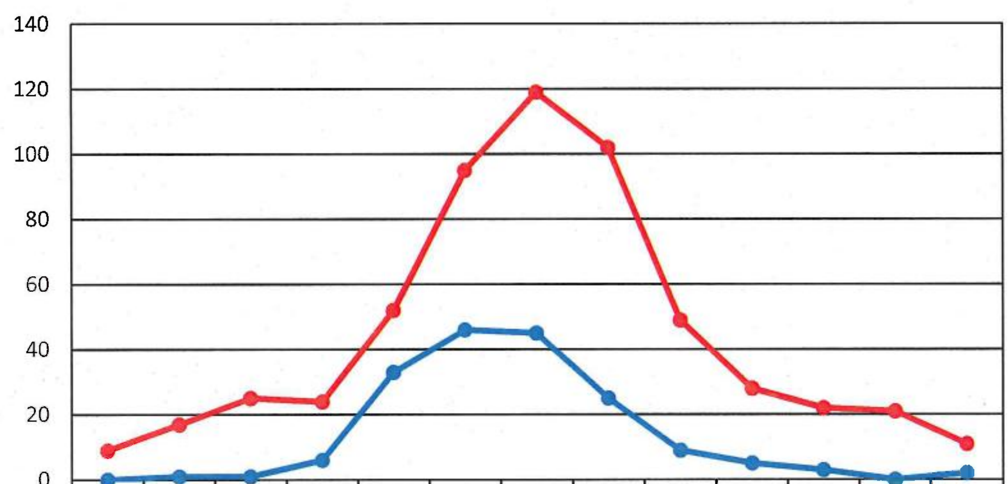
Authorized and Pending Lawsuits

During 2019 PLFCS obtained authority from the FDIC Board of Directors to sue the former Chairman of The National Republic Bank of Chicago ("NRB"), Chicago, Illinois, in connection with dividends NRB paid to him through its holding company. PLFCS filed suit against the former Chairman on October 21 in the U.S. District Court for the Northern District of Illinois. NRB failed on October 24, 2014, with $843 million in assets.

PLFCS also filed a lawsuit in July in the U.S. District Court for the Northern District of Georgia against Certain Underwriters at Lloyd's London ("Lloyd's") seeking more than $3 million in damages under a Georgia statute requiring payment of interest on liquidated demands. The FDIC asserts that interest accrued from 2013, when a federal court entered a $10 million judgment against a former officer of Omni National Bank, Atlanta, Georgia, through 2018 when Lloyd's paid the FDIC the $10 million judgment amount under a D&O liability policy after exhausting all judicial rights to contest coverage.

As of year-end, 19 professional liability lawsuits were pending, 8 of which were MMF lawsuits. The following graph shows pending professional liability civil cases excluding MMF cases from 2007 through year-end 2019. ("Pending" actions include claims that the FDIC as Receiver itself filed as well as claims that institutions filed before they failed and that the FDIC inherited as Receiver.)

FDIC Professional Liability Civil Actions, 2007-2019
(Excludes MMF)



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
FDIC Pending	9	17	25	24	52	95	119	102	49	28	22	21	11
FDIC Filed	0	1	1	6	33	46	45	25	9	5	3	0	2

Significant Developments During 2019

In 2019 the FDIC as Receiver for 39 failed banks and thrifts continued to litigate two large lawsuits in the U.S. District Court for the Southern District of New York and in London, England, alleging that 34 defendants wrongfully suppressed the London Interbank Offered Rate ("LIBOR") resulting in substantial damages to the failed institutions. The New York case is part of a multi-district litigation ("MDL") for LIBOR suppression claims. On March 25 the New York court granted in part and denied in part the defendants' motions to dismiss receivership claims on behalf of Doral Bank, applying its previous rulings on claims by the 38 other receiverships. Neither court has set a discovery or trial schedule yet for the FDIC's claims.

The FDIC in 2019 continued to pursue state and federal securities law claims in six RMBS cases out of five receiverships: Guaranty (2 cases); Colonial (2 cases); United Western Bank ("UWB"), Denver, Colorado (1 case); and Citizens National Bank, Macomb, Illinois, and Strategic Capital Bank, Champaign, Illinois (together, "Citizens/Strategic") (1 combined case). Both cases out of Guaranty and one case out of Colonial settled during 2019. In the remaining Colonial case, which is pending in the federal court for the Southern District of New York, discovery is nearly complete and one motion for partial summary judgment is pending. In the UWB case, discovery is complete, and shortly after year-end the court denied defendants' motion for summary judgment. In the Citizens/Strategic case, fact discovery is currently underway.

On March 20 the New York district court granted the defendants' motion to dismiss three amended complaints that the FDIC as Receiver for Guaranty had filed against Citibank, N.A. ("Citibank"), The Bank of New York Mellon, and U.S. Bank, N.A., as trustees of 15 RMBS trusts. The FDIC had alleged that the defendants breached their contracts as RMBS trustees by failing to enforce contractual rights to protect the quality of the collateral loans backing the RMBS in the trusts. In March 2018, the defendants filed a joint motion to dismiss arguing that the FDIC lacked standing to bring the claims because Citibank had not ratified the lawsuits. The FDIC responded that Citibank had improperly refused to ratify the lawsuits and thus should be deemed to have ratified. The court rejected the FDIC's position and dismissed the lawsuits.

In March and July, the Georgia Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit ("Eleventh Circuit"), respectively, issued decisions that fully resolved an appeal after a trial in which a jury found eight former directors and officers of Buckhead Community Bank ("Buckhead"), Atlanta, Georgia, liable for negligence and gross negligence in approving four loans and awarded the FDIC as Receiver for Buckhead more than $4.98 million in damages. The defendants appealed to the Eleventh Circuit, which certified three questions of Georgia law to the Georgia Supreme Court. The Georgia Supreme Court held that, although Georgia's apportionment statute applies to tort claims for pecuniary losses, it did not apply in this case if the defendants were found to have "acted in concert" under Georgia common law, in which case their liability would be joint and several. Relying on these answers, the Eleventh Circuit concluded that the trial court had properly declined to instruct the jury to apportion fault among the defendants and in addition had not erred in allowing the jury to impose liability on directors or officers who had not attended loan approval meetings. On November 1 the FDIC received payment of $5,137,498 in full satisfaction of the judgment. The payment includes the full amount awarded plus court costs and post-judgment interest. Buckhead failed on December 4, 2009, with $856 million in assets.

In March and December, in two separate cases (one in Illinois and one in Louisiana), federal courts granted motions filed by the FDIC to enforce administrative subpoenas. In the Illinois case, the FDIC as Receiver for Washington Federal Bank for Savings ("WashFed"), Chicago, Illinois, sought audit files, work papers, audit manuals, and other audit-related documents, and a liability insurance policy from Bansley & Kiener, L.L.P. ("Bansley"), WashFed's outside auditor. The court held that the FDIC's subpoena was issued for a proper purpose and did not violate Bansley's Fourth Amendment rights and that the Illinois accountant privilege did not protect Bansley's documents from disclosure in response to a federal administrative subpoena. In the Louisiana case, Ernst & Young ("EY"), the former external auditor of First NBC Bank ("FNBC"), New Orleans, Louisiana, and its holding company, refused to produce a witness for an administrative deposition by the FDIC as Receiver for FNBC. EY contended that the Public Company Accounting Oversight Board ("PCAOB") had improperly provided the FDIC Receiver with confidential information relating to EY. The court found that the PCAOB's statute explicitly allows the PCAOB to share confidential information with the FDIC Board of Directors, which in turn has legal authority to share it with the FDIC Receiver since the FDIC Board acts for the FDIC in both its receivership and corporate capacities. The court also awarded the FDIC its costs incurred in enforcing the subpoena.

PLFCS Workload and Staffing at Year-End

During 2019 four FDIC-insured financial institutions failed. The largest was City National Bank of New Jersey, Newark, New Jersey, which failed on November 1 with $120.6 million in assets. For each institution that fails, PLFCS opens 11 different types of investigations, although most are soon closed once it becomes clear that no viable claims exist.[1] As of year-end 2019, PLFCS had 100 open institutions[2] (comprising 56 with active investigations or litigation and another 44 open solely for collection purposes[3]), 19 pending professional liability lawsuits (8 of which were MMF lawsuits), open investigations in 51 claim areas out of 9 open institutions, and 67 collection matters out of 50 institutions. The following graph shows PLFCS's open investigations workload from 2007 through 2019.

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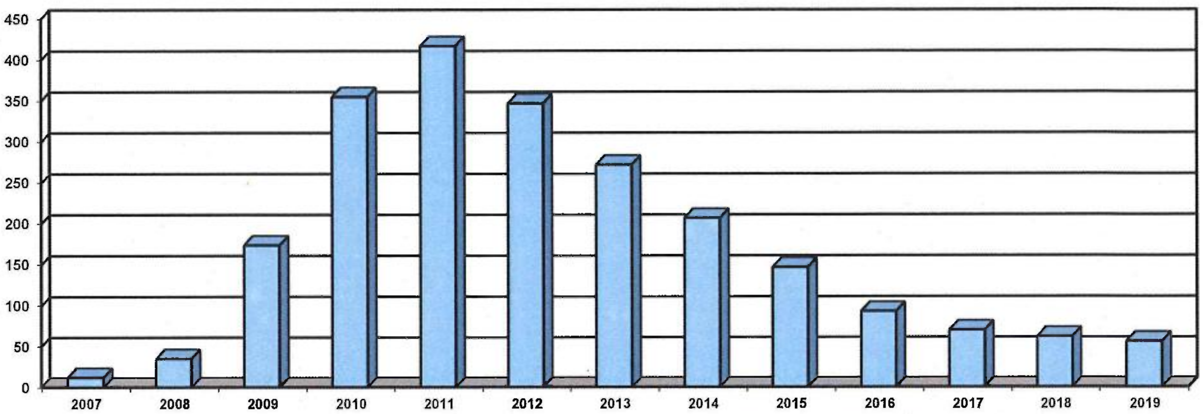
1 The 11 types of investigations are: (1) D&O, (2) fidelity bond, (3) MMF, (4) attorney, (5) accountant, (6) appraiser, (7) securities (including RMBS), (8) commodities, (9) insurance, (10) insurance issuer, and (11) other. Some institutions have multiple matters open.

2 All institutions in PLFCS's inventory are failed institutions. For PLFCS management purposes, however, a failed institution is "open" in PLFCS while PLFCS is working on any matter relating to that failed institution, and an "open investigation" is an investigation in PLFCS's inventory that is still active because it has not yet been settled or otherwise resolved.

3 Collection matters include matters for which recoveries are obtained as a result of judgments, structured settlements, or claims submitted in bankruptcy proceedings, probate estates, or class action lawsuits. Staff's activity on these matters ranges from monitoring the matters for recovery sources, continuing to collect scheduled payments, or actively pursuing legal collection remedies.

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



During the recent financial crisis, PLFCS staff working on professional liability matters peaked at the end of 2010 with 68 total managers and staff consisting largely of term employees. Since that time, total staff have declined as a result of term departures and retirements. As of year-end, PLFCS had 20 total staff working on professional liability (as distinguished from financial crimes) matters, including 3 permanent managers, 1 temporarily promoted manager, 11 attorneys (2 of whom were term employees), and 5 non-attorney employees.[4]

Conclusion

During 2019 the FDIC's professional liability program continued to operate cost-effectively recovering a total of $626,448,482 and incurring total expenses of $27,602,808 as PLFCS and DRR continued to devote substantial resources to professional liability investigations and litigation matters.

[4] As of the end of 2019, PLFCS staff working exclusively on financial crimes matters included three permanent attorneys and two permanent staff employees in Virginia Square and one temporarily promoted manager in the Dallas Regional Office.

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES ($ MILLIONS)

	Recoveries[5]	In-House PLFCS Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses[6]	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
2019	$626.4	$6.8	$1.9	$18.9	$27.6	33.1 to 1	22.7 to 1
2018	$116.3	$9.4	$2.1	$35.8	$47.3	3.25 to 1	2.46 to 1
2017	$105.4	$8.8	$6.4	$48.4	$63.5	2.18 to 1	1.66 to 1
2016	$470.9	$9.2	$5.5	$58.8	$73.5	8.00 to 1	6.40 to 1
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	$10,385.4	$267.9	$425.0	$1,757.3	$2,452.7	5.91 to 1	4.23 to 1

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

[6] Expenses include Drexel-Milken expenses of $106.1 million. The following categories of expenses are unavailable: all FSLIC fees and expenses for 1986-1988; FSLIC in-house (legal and investigation) expenses for 1989; and 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.