

MEMO

TO: Board of Directors

THROUGH: Nicholas J. Podsiadly
General Counsel

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Date: 2021.03.01 20:13:59 -05'00'

FROM: Melanie D. Coates
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Date: 2021.02.26 10:14:54 -05'00'

DATE: February 26, 2021

RE: Professional Liability Annual Report for 2020

The Professional Liability Unit (PLU) of the Legal Division of the Federal Deposit Insurance Corporation (FDIC) submits this report on the results of the professional liability program for 2020. The purposes of the professional liability program are 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. PLU also assists DRR and the Legal Division's Financial Crimes Unit to obtain criminal restitution from defendants convicted of banking crimes and, where appropriate, refers cases to the Legal Division's Enforcement Section for administrative enforcement action.

Recoveries and Expenses

During 2020 PLU and DRR recovered \$47,422,404 and incurred \$17,290,758 in expenses for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries - 2020
Director and Officer (D&O) Liability	\$31,976,903 (67.4%)
Accountant Malpractice	\$13,750,000 (29.0%)
Attorney Malpractice	\$800,000 (1.7%)
Securities	
Securities - Other	\$432,482 (0.9%)
Residential Mortgage-Backed Securities (RMBS)	\$299,226 (0.6%)
Mortgage Malpractice or Mortgage Fraud (MMF)	\$163,793 (0.4%)
TOTAL	\$47,422,404 (100.0%)

The \$31.98 million in D&O liability recoveries resulted from settlement of claims out of three receiverships. The largest of these recoveries was \$28,908,892 from the settlement of a lawsuit

against 19 former directors and officers of R-G Premier Bank of Puerto Rico (R-G Premier), Hato Rey, Puerto Rico, their spouses and conjugal partnerships, and their D&O liability insurance carrier. The FDIC sued the D&O defendants for losses caused by their gross negligence and breaches of fiduciary duties. R-G Premier failed on April 30, 2010, with \$5.68 billion in assets.

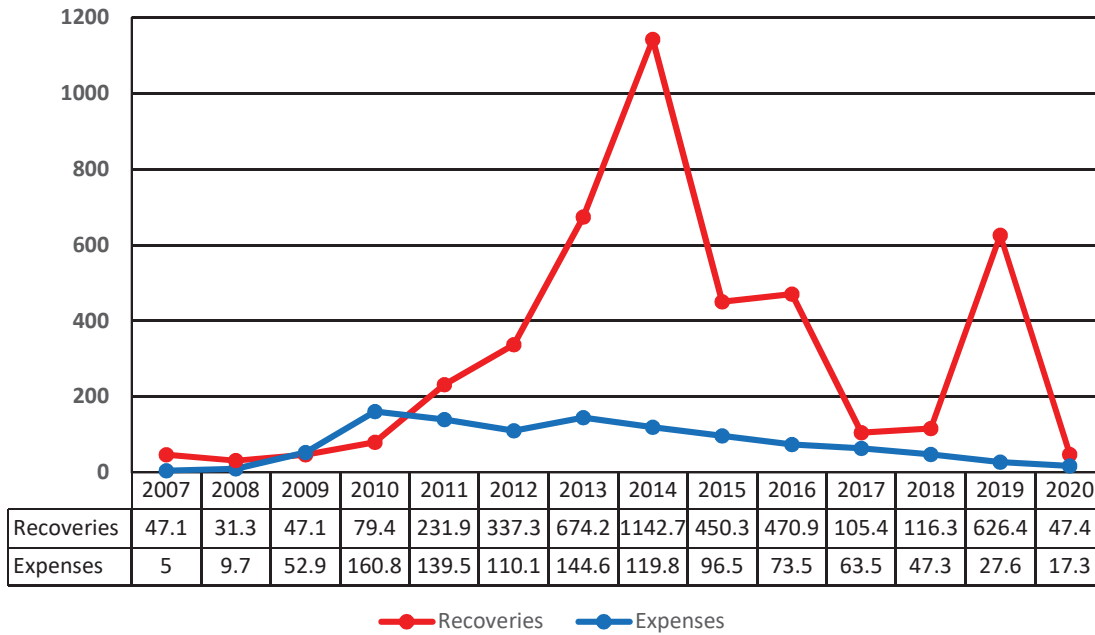
The \$13.75 million in accountant malpractice recoveries resulted from settlements of claims out of two receiverships. The larger recovery was \$11.25 million from the settlement of claims against Crowe Horwath, LLP (Crowe), the former independent external auditor of Valley Bank (Valley), Moline, Illinois, based on Crowe's issuance of unqualified audit opinions in 2010 and 2011 despite warnings from its own auditors that Valley's Chief Executive Officer was manipulating Valley's financial statements to mask its financial condition. Valley failed on June 20, 2014, with \$456.4 million in assets.

The \$800,000 in attorney malpractice recoveries resulted from claims settled in 2003 against Kutak Rock LLP (Kutak), the outside general counsel of The First National Bank of Keystone, Keystone, West Virginia, which failed in 1999. As part of the settlement, Kutak assigned the proceeds of a \$10 million excess liability insurance policy issued by Reliance Insurance Company (Reliance) to the FDIC. With the \$800,000 distribution, the Reliance liquidator has paid the FDIC a total of \$10 million, the full policy limits available to the FDIC. In total, the FDIC has collected \$22.1 million from the Kutak settlement.

Of the total program expenses of \$17,290,758 in 2020, the Legal Division incurred \$15,579,305 (90.1 percent), DRR incurred \$1,706,904 (9.9 percent), and other FDIC Divisions and Offices incurred \$4,548 (0.03 percent). Legal Division expenses comprise \$10,456,316 paid to outside counsel and consultants and \$5,122,989 for other expenses (primarily salaries and travel expenses for in-house PLU employees). DRR expenses are entirely expenses of in-house staff. The ratio of total recoveries to total expenses is 2.7 to 1, and the ratio of recoveries to outside counsel and consultant expenses only is 4.5 to 1.

Professional liability program expenses during 2020 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 2007. Typically, program expenses are incurred years before associated recoveries are received because staff spends substantial time and money to develop claims before settlements or judgments are obtained. Program expenses also include substantial 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 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 earlier reporting periods. Given this characteristic lag in the incurrence of program expenses and the receipt of associated recoveries, the cost-effectiveness of the program is best assessed by relating recoveries to expenses over many years rather than in any single reporting period.

**FDIC Professional Liability Recoveries and Expenses
2007-2020 (\$millions)**



As shown in the attached historical table, from 1986 through 2020 the overall recoveries-to-expenses ratio for the professional liability program is 4.2 to 1.

Report on Total Recoveries and Expenses From 2007 Through 2020

To show the relative significance of different types of recoveries in more recent years, the following table lists recoveries by type from 2007 through December 31, 2020.

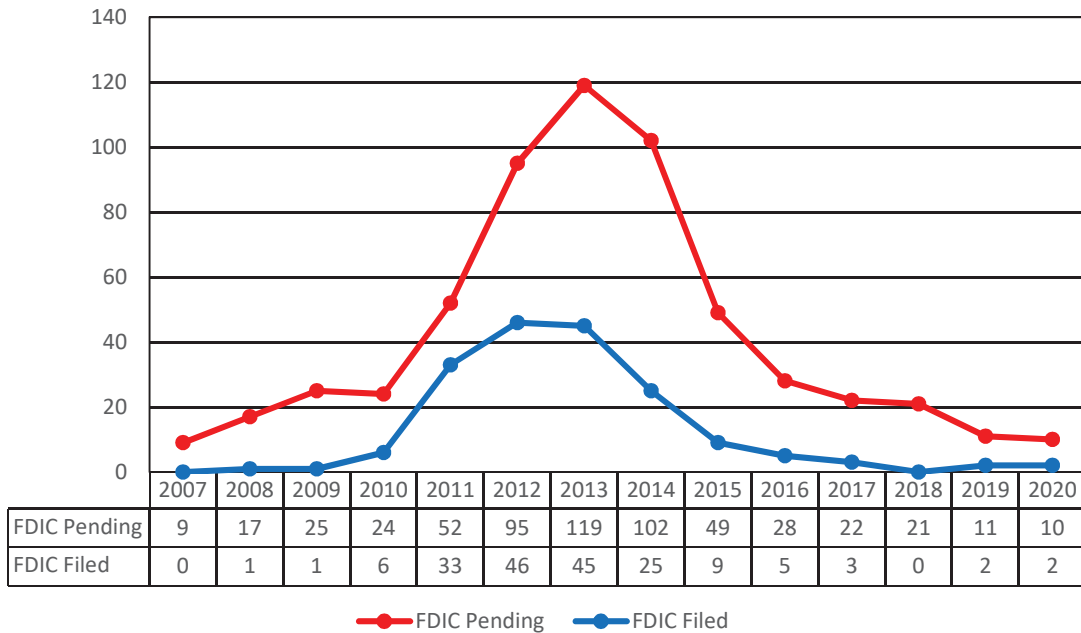
Type of Claim	Total Recoveries - 2007-2020	
Securities		
RMBS	\$1,969,488,409	(44.7%)
Other	\$62,850,022	(1.4%)
D&O Liability	\$1,325,717,105	(30.1%)
Accountant Malpractice	\$461,635,367	(10.5%)
MMF	\$237,439,706	(5.4%)
Fidelity Bond	\$203,729,058	(4.6%)
Appraiser Malpractice	\$45,738,132	(1.0%)
Attorney Malpractice	\$44,424,157	(1.0%)
Miscellaneous	\$34,400,065	(0.8%)
Insurance	\$22,478,837	(0.5%)
TOTAL	\$4,407,900,858	(100.0%)

Authorized and Pending Lawsuits

During 2020 PLU obtained authority from the FDIC Board to sue certain officers and directors of First NBC Bank (FNBC) for breach of fiduciary duty and gross negligence and against FNBC’s D&O liability insurance carriers for coverage for the claims. The FDIC filed the suit under seal in April in the U.S. District Court for the Eastern District of Louisiana. The case is currently stayed at the request of the United States Attorney’s Office for the Eastern District of Louisiana pending completion of related criminal proceedings. PLU also obtained authority to sue Ernst & Young LLP (EY), the former independent auditor of FNBC, for EY’s negligence in failing to audit properly FNBC’s 2014 and 2015 consolidated financial statements and to sue EY’s malpractice carrier for coverage for the action. The FDIC filed this suit in the U.S. District Court for the Eastern District of Louisiana on April 22 claiming at least \$125 million in damages. The lawsuit also is currently stayed pending conclusion of FNBC-related criminal proceedings. FNBC failed on April 28, 2017, with \$3.325 billion in assets.

As of year-end, 18 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 2020. (“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, 2007-2020
(Excludes MMF)



Significant Developments During 2020

In 2020 the FDIC as Receiver for 39 failed banks and thrifts continued to litigate two large lawsuits in the federal district court for the Southern District of New York and in the High Court of Justice in London, England, alleging that 34 defendants wrongfully suppressed the U.S. Dollar London Interbank Offered Rate (LIBOR) causing damages to the 39 institutions. The claims pending in New York are part of a multi-district litigation for LIBOR suppression claims. In June the FDIC as Receiver

submitted filings in both lawsuits to dismiss claims by 19 of the failed bank receiverships that the FDIC determined are no longer cost-effective to pursue. Those motions remain pending. In July the court in the London lawsuit denied a motion filed in 2017 to strike the FDIC's claims in that case, and the FDIC recovered \$696,453 in costs incurred in opposing that motion.¹ Neither court has yet set a discovery or trial schedule for the FDIC's claims.

The FDIC in 2020 continued to pursue state and federal securities law claims in three RMBS cases out of four receiverships: Colonial Bank (Colonial), Montgomery, Alabama; United Western Bank (UWB), Denver, Colorado; and Citizens National Bank, Macomb, Illinois, and Strategic Capital Bank, Champaign, Illinois (together, Citizens/Strategic) (1 combined case). In the Colonial case, which is pending in federal court for the Southern District of New York, discovery is nearly complete, but the court has not set a trial date. In March, the Colonial court dismissed the FDIC's claims on two RMBS against one of the underwriters on the grounds that the underwriter did not participate in the distribution of the specific tranches of the securities that Colonial had purchased. Claims on those same securities remain pending against the underwriters of the tranches that Colonial did purchase. In the UWB case, the court granted partial summary judgment in favor of the FDIC in January, ruling, among other things, that Colorado's statutory interest rate of 8 percent is the appropriate interest rate with which to calculate the FDIC's damages. In the Citizens/Strategic case, fact discovery is currently underway.

On February 26 the Florida Third District Court of Appeals in a 2-1 decision affirmed the dismissal as time-barred of a lawsuit that the FDIC as Receiver for BankUnited, FSB (BankUnited), Coral Gables, Florida, had filed against Nationwide Equities Corporation (Nationwide) as time-barred. The FDIC sued Nationwide in federal court for breach of its mortgage broker agreement (MBA) with BankUnited, but the court dismissed that case because the MBA contained a forum selection clause requiring suit to be filed in Florida state court. After the FDIC refiled its lawsuit in state court, the court granted Nationwide's motion to dismiss, ruling that the statute of limitations had expired while the suit was pending in federal court. On appeal, the FDIC argued, among other things, that judicial estoppel prevented Nationwide from seeking dismissal on limitations grounds since it had represented to the federal court that the FDIC had an adequate and available forum in state court. The FDIC's request for rehearing from the Florida Appeals Court was denied, as was the FDIC's petition to the Florida Supreme Court. All appeals are now final.

In March the U.S. District Court for the Northern District of Illinois entered a judgment in favor of the FDIC as Receiver for Founders Bank (Founders), Worth, Illinois, against Chicago Title Insurance Company and Chicago Title and Trust Company (Chicago Title) two and a half years after a jury had found Chicago Title liable for breach of contract, breach of fiduciary duty, negligence, and negligent misrepresentation. Chicago Title, as escrow agent, closed four real-estate transactions financed by Founders without disclosing that they were the subject of same-day flips that inflated the values of the properties. Although the jury awarded the FDIC \$1.45 million in damages, the court reduced the award by \$500,000, the amount of the FDIC's settlement with the firm that had appraised the four

¹ These recoveries are not included in the total recoveries reported for 2020 but will be included in 2021 recoveries.

properties. The FDIC has appealed the court's rulings on damages and prejudgment interest to the U.S. Court of Appeals for the Seventh Circuit.²

In August the U.S. District Court for the Northern District of Georgia granted a motion for summary judgment filed by Certain Underwriters at Lloyd's London (Underwriters) and denied a motion for summary judgment filed by the FDIC as Receiver for Omni National Bank (Omni), Atlanta, Georgia, in an insurance coverage lawsuit. In July 2018, after losing a declaratory judgment action and an appeal on insurance coverage issues, Underwriters paid the FDIC the \$10 million limits of a D&O liability insurance policy that it had issued to Omni. After Underwriters refused to pay \$3 million in statutory prejudgment interest, the FDIC filed suit to collect the \$3 million. The district court held that the FDIC's demand for statutory interest was untimely because the FDIC should have requested interest before the court entered judgment in the declaratory judgment action. The court did not address the FDIC's argument that a request for statutory interest was not appropriate in the declaratory judgment action because the FDIC in that action had sought a ruling only on the issue of insurance coverage; it had not sought a money judgment. On September 22 staff filed a notice of appeal to the U.S. Court of Appeals for the Eleventh Circuit seeking reversal of the judgment. Omni failed on March 27, 2009, with \$979.6 million in assets.

In October 2020, in a 2-1 decision, the U.S. Court of Appeals for the Fifth Circuit vacated a lower court decision enforcing an administrative subpoena that PLU had issued to a former employee of EY, the former external auditor of FNBC. The employee contended that the subpoena was unenforceable because the FDIC as Receiver had improperly received documents from the Public Company Accounting Oversight Board (PCAOB). The PCAOB shared the documents after concluding that its statute authorized sharing with the FDIC. However, the Fifth Circuit reasoned that Congress authorized sharing only with one regulator, which the majority presumed to be the Federal Reserve, the regulator of FNBC's holding company, and it added that, even if the FDIC were deemed to be the relevant regulator, Congress only authorized the PCAOB to share documents with the FDIC Board and did not explicitly authorize sharing with the FDIC as Receiver. The court remanded the case without addressing the remedy for the improper sharing. The dissenting judge concluded that the appeal was moot because the deposition of the employee had already taken place before the Fifth Circuit ruled.

PLU Workload and Staffing at Year-End

During 2020 four FDIC-insured financial institutions failed. The largest was The First State Bank, Barboursville, West Virginia, which failed on April 3, with \$151.8 million in assets. 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 year-end 2020, PLU had 106 open institutions⁴

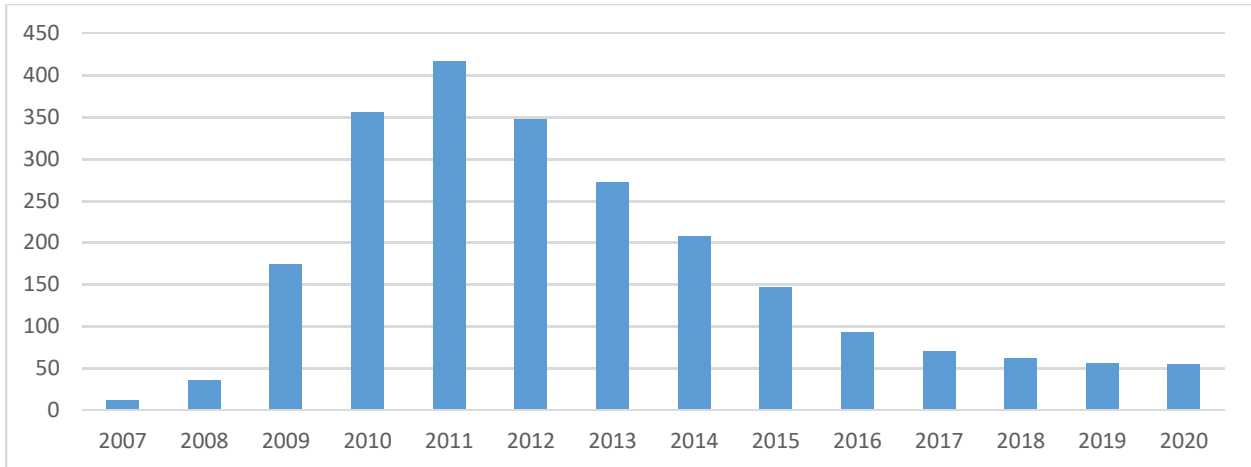
² Chicago Title also filed a notice of appeal, but withdrew its appeal before its brief was due. Oral argument before the appellate court is scheduled for April 2021.

³ 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.

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

(comprising 55 with active investigations or litigation and another 51 open solely for collection purposes⁵), 18 pending professional liability lawsuits (8 of which were MMF lawsuits), open investigations in 53 claim areas out of 9 open institutions, and 90 collection matters out of 63 institutions (51 of which are open for collection only and 12 of which have other active investigations or litigation). The following graph shows PLU’s open investigations and lawsuits workload from 2007 through 2020.

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



During the recent financial crisis, PLU’s overall staffing increased sharply, peaking at the end of 2010 with 68 total managers and staff, consisting largely of term employees. Since that time, staff has steadily declined as a result of term departures and retirements. PLU’s last two term employees left PLU in the first half of 2020. As of year-end, PLU had 21 total staff working on professional liability (as distinguished from financial crimes) matters.

Conclusion

During 2020 the FDIC’s professional liability program continued to operate cost-effectively recovering a total of \$47,422,404 and incurring total expenses of \$17,290,758 as PLU and DRR continued to devote substantial resources to professional liability investigations and litigation. The program also has continued to operate cost-effectively overall, recovering a total of \$10.4 billion and incurring total expenses of \$2.5 billion from 1986 through the end of 2020.

investigation” is an investigation in PLU’s inventory that is still active because it has not yet been settled or otherwise resolved.

⁵ 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, collecting scheduled payments, and actively pursuing legal collection remedies.

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES (\$ MILLIONS)

	Recoveries*	In-House PLU Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses**	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
2020	\$47.4	\$5.1	\$1.7	\$10.5	\$17.3	4.5 to 1	2.7 to 1
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	\$7.7	\$2.3	\$5.0	20.62 to 1	9.40 to 1
2006	\$34.5	\$2.6	\$9.9	\$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	\$10,432.8	\$273.0	\$426.7	\$1,767.8	\$2,470.0	5.91 to 1	4.2 to 1

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

** 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.