FDIC Federal Deposit Insurance Corporation

MEMO

TO: Board of Directors

THROUGH: Harrel M. Pettway
General Counsel

HARREL PETTWAY Digitally signed by HARREL PETTWAY Date: 2024.03.12 17:50:39 -04'00'

FROM: Melanie D. Coates
Assistant General Counsel
Professional Liability and Financial Crimes Section

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DATE: March 5, 2024

RE: Professional Liability Annual Report for 2023

The Professional Liability and Financial Crimes Section (PLFCS) of the Legal Division of the Federal Deposit Insurance Corporation (FDIC) submits this report on the results of the professional liability program for 2023. 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, PLFCS, the Investigations Department of the Division of Resolutions and Receiverships (DRR), and for certain large institutions, the Division of Complex Institution Supervision and Resolution (CISR), 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. PLFCS also assists DRR and the Legal Division's Financial Crimes program in obtaining 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 2023, PLFCS and DRR recovered $40,751,738 and incurred $18,631,515 in expenses for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries—2023	
Securities		
Residential Mortgage-Backed Securities (RMBS)	$27,000,000	(66.3%)
Attorney	$7,579,618	(18.6%)
Director and Officer (D&O)	$3,110,916	(7.6%)
Mortgage Malpractice and Fraud (MMF)	$2,427,000	(6.0%)
Financial Instruments		
U.S. Dollar London Interbank Offered Rate (LIBOR)	$584,936	(1.4%)
Other Benchmark Rates	$49,268	(0.1%)
TOTAL	**$40,751,738**	**(100%)**

The $27 million in RMBS recoveries resulted from the settlement of RMBS claims against NatWest Markets Securities Inc., formerly RBS Securities Inc. (RBS), in a lawsuit out of Colonial Bank (Colonial), Montgomery, Alabama, in the U.S. District Court for the Southern District of New York. The settlement resolved the FDIC's claims against RBS for violations of state and federal securities laws based on misrepresentations in the offering documents for three RMBS certificates that Colonial purchased, claims on two of which were dismissed in 2020. The settlement resolves all remaining RMBS litigation out of Colonial. In total, the FDIC recovered nearly $660 million and spent $52.2 million on outside counsel and consultants in connection with all Colonial RMBS claims. Colonial Bank failed on August 14, 2009, with $25.5 billion in assets.

The $7.6 million in Attorney recoveries arose out of two receiverships, with the largest recovery of $5,912,951 resulting from return of unspent attorney fees that Signature Bank (Signature), New York, New York, had advanced to a law firm hours before Signature was closed. A portion of the advanced fees were returned after FDIC staff demanded an accounting of time as well as invoices from the law firm to justify the payment.

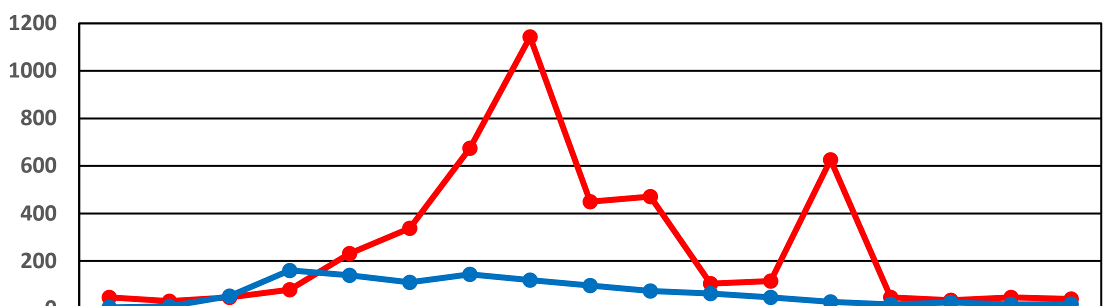
The $3.1 million in D&O recoveries resulted primarily from the settlement of claims out of Omni National Bank (Omni), Atlanta, Georgia, against Certain Underwriters at Lloyd's, London (Underwriters) for Underwriters' failure to pay statutory interest on insurance coverage claims. In July 2018, after 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. In July 2019, the FDIC sued Underwriters for statutory interest in excess of $3 million that had accrued from Underwriters' delayed payment of the $10 million. After an August 2020 ruling from the federal district court denying the FDIC's claim as untimely, in August 2022, the U.S. Court of Appeals for the Eleventh Circuit reversed and remanded the case to the district court to determine when interest began to run. The settlement fully resolved all of the claims in the action.

Of the total 2023 expenses of $18,631,515, the Legal Division incurred $15,970,588 (85.7 percent), DRR incurred $2,636,869 (14.1 percent), CISR incurred $10,681 (0.1 percent), and other divisions incurred $13,377 (0.1 percent). Of those expenses, Legal

Division expenses comprise $11,012,700 paid to outside counsel and consultants and $4,957,888 for other expenses (primarily in-house PLFCS salaries and travel expenses associated with the professional liability program). All expenses for DRR and CISR are entirely expenses for in-house staff. The ratio of total recoveries to total expenses is 2.2 to 1, and the ratio of recoveries to outside counsel and consultant expenses only is 3.7 to 1.

Professional liability program expenses are primarily receivership funding expenses incurred by PLFCS and DRR to conduct professional liability investigations and litigation. Typically, program expenses are incurred years before associated recoveries are received because staff spends substantial time and money to investigate and 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, 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 time between 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
2007-2023 ($millions)



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Recoveries	47.1	31.3	47.1	79.4	231.9	337.3	674.2	1143	450.3	470.9	105.4	116.3	626.4	47.4	35.1	47.3	40.8
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	17.3	25.4	16.8	18.6

Recoveries Expenses

As shown in the attached historical table, from 1986 through 2023 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 2023

Total amounts recovered from different claim types from January 1, 2007, through December 31, 2023, are shown in the following table.

Type of Claim	Total Recoveries – 2007-2023
Securities	
RMBS	$2,070,643,910 (45.7%)
Other	$65,002,496 (1.4%)
D&O Liability	$1,329,604,933 (29.3%)
Accountant Malpractice	$461,635,367 (10.2%)
MMF	$243,869,946 (5.4%)
Bond	$204,239,458 (4.5%)
Attorney Malpractice	$52,003,775 (1.2%)
Appraiser Malpractice	$45,738,132 (1.0%)
Other Professional Claims	$34,413,216 (0.8%)
Insurance/Issuer	$22,478,837 (0.5%)
Financial Instruments	$1,401,504 (0.0%)
TOTAL	**$4,531,031,574 (100.0%)**

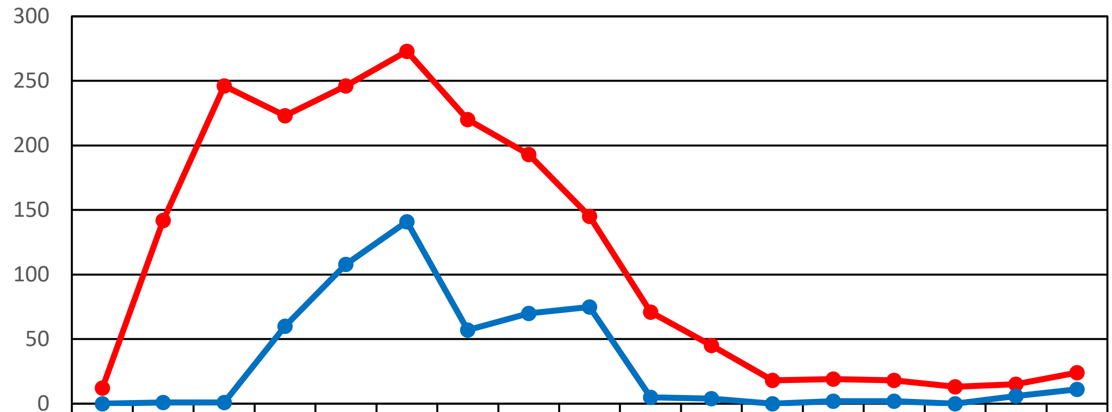
Authorized and Pending Lawsuits

During 2023, the FDIC Board of Directors approved one, and delegated authority approved four, MMF cases, all of which authorized the FDIC to sue mortgage brokers for indemnification. The largest of the five approved cases is against CTX Mortgage Company, LLC (CTX), and Pulte Mortgage, LLC (Pulte Mortgage) as successor to CTX, for loans that CTX brokered to Washington Mutual Bank (WaMu), Henderson, Nevada, and that WaMu in turn sold to RMBS trusts. The FDIC settled claims related to defective loans that WaMu sold to RMBS trusts for a $3 billion receivership certificate. Because CTX contractually agreed to indemnify WaMu for losses resulting from defective loans it brokered to WaMu, the FDIC seeks to recover the portion of its settlement with the RMBS trustee attributable to losses on the CTX loans. On August 28, the FDIC filed the approved lawsuit against CTX and Pulte Mortgage in federal court in the Central District of California seeking contractual indemnification plus attorney's fees and pre-judgment interest. In total, the FDIC filed 11 MMF lawsuits during the year. WaMu failed on September 25, 2008, with $307 billion in assets.

As of year-end, 24 professional liability lawsuits were pending. These included 1 D&O liability case, 1 probate case, 2 LIBOR cases, 1 RMBS case; 1 accounting malpractice case; 1 financial institution bond case; 14 MMF lawsuits; and 2 class action securities law cases and 1 securities case in which the FDIC is a defendant or is seeking to intervene in order to seek dismissal of the pending cases.

The following graph shows pending professional liability lawsuits from 2007 through year-end 2023. (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 Lawsuits, 2007-2023[1]



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
FDIC Pending	12	142	246	223	246	273	220	193	145	71	45	18	19	18	13	15	24
FDIC Filed	0	1	1	60	108	141	57	70	75	5	4	0	2	2	0	6	11

FDIC Pending FDIC Filed

<u>Significant Developments During 2023</u>

During 2023, the FDIC continued to litigate two LIBOR suppression cases on behalf of 20 receiverships – one in the U.S. District Court for the Southern District of New York (New York case) in a multidistrict litigation (MDL) and one in the High Court of Justice in London, England (London case). In 2022, after a series of appellate rulings reversing the lower court's dismissal of certain foreign defendants on personal jurisdiction grounds, almost all of the foreign defendants were reinstated in the MDL cases. The district court, however, declined to reinstate the three British Bankers' Association (BBA) defendants opining that the appellate rulings did not apply to the BBA defendants. The FDIC and similarly situated plaintiffs filed a petition for a writ of *mandamus* challenging that ruling, but in 2023 the U.S. Court of Appeals for the Second Circuit denied the petition. The BBA defendants, thus, remain dismissed from the New York case but are still defendants in the FDIC's London case. During 2023, discovery proceeded in both the New York and London cases. In the New York case, depositions of fact witnesses began in late 2023, occurring in both the United States and abroad, with additional depositions scheduled for early 2024. The first stage of discovery is set to conclude in the New York case in mid-2024 and is expected to conclude in the London case in 2025. No trial date has been set for the New York case. The London case is set for trial in early 2026 for claims out of three of the plaintiff receiverships.

During 2023, the FDIC continued to pursue securities law claims in two RMBS cases, one out of Colonial and one out of Citizens National Bank (Citizens), Macomb, Illinois. As discussed above, the Colonial case settled in 2023, leaving only the Citizens case remaining

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1 In prior reports, the number of MMF cases was separately reported and not included in this graph. This report combines the total number of lawsuits, including MMF lawsuits, filed and pending during the years 2007 through the end of 2023.

in litigation. In that case, expert discovery has been stayed pending resolution of a motion for summary judgment that Deutsche Bank filed in 2022. In the motion, Deutsche Bank seeks a judgment that, although it was the lead underwriter of the RMBS at issue, because Citizens purchased a subordinate tranche of the certificate that was sold by another underwriter, Deutsche Bank is not liable for the claims alleged. No trial date has been set in the case.

During 2023, PLFCS also continued to litigate two lawsuits out of First NBC Bank (FNBC), New Orleans, Louisiana: an accounting malpractice lawsuit against Ernst & Young (EY), FNBC's former external auditor; and a D&O lawsuit against 7 former directors of FNBC and 10 D&O liability insurers. Both cases, which had been stayed since 2020, were reopened after the February 9 conclusion of a criminal trial of one of the D&O lawsuit defendants, Ashton Ryan, Jr., the former President, CEO, and Chairman of the Board of FNBC. The jury found Ryan guilty on all counts.

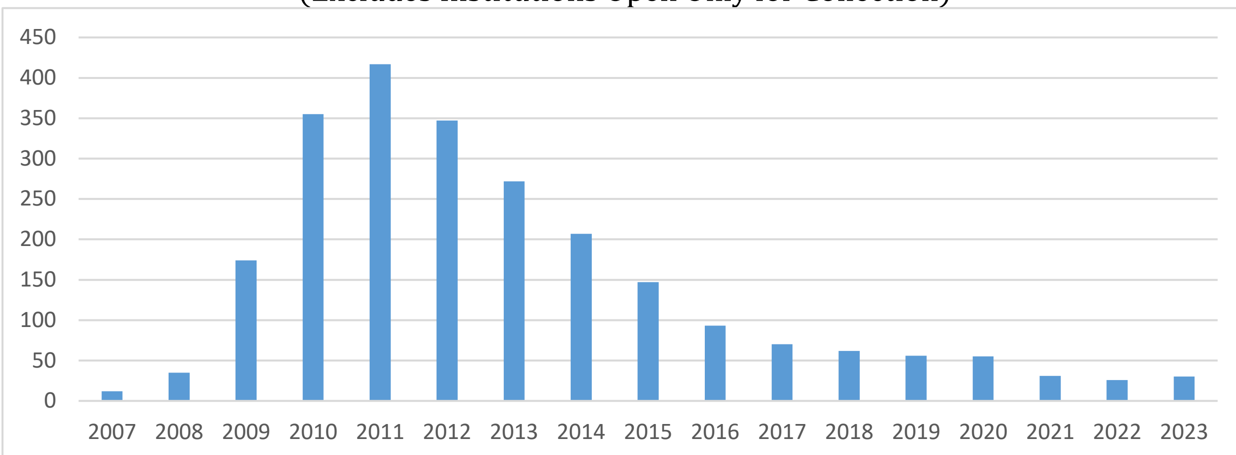
Shortly after the stay was lifted in the EY lawsuit, EY moved to disqualify the FDIC's counsel based on the voluntary production by the Public Company Accounting Oversight Board (PCAOB) to the FDIC of investigative materials pertaining to EY. The PCAOB had concluded that its governing statute permitted such sharing with the FDIC. However, in 2020, the U.S. Court of Appeals for the Fifth Circuit (Fifth Circuit) ruled that the PCAOB was not authorized to share those materials with the FDIC and remanded the matter to the U.S. District Court for the Eastern District of Louisiana for further proceedings. Although the district court found that the FDIC's attorneys did not violate any ethics rules and did not act in bad faith in receiving and reviewing the PCAOB documents, on June 15 it granted EY's motion to disqualify the FDIC's counsel on the ground that prejudice "could accrue" to EY from FDIC counsel's review of the materials. The court made no specific findings of actual prejudice to EY. In August, the Fifth Circuit declined to accept an interlocutory appeal of the decision despite the district court's certification of the appeal.

<u>PLFCS Staffing and Workload at Year-End</u>

During 2023, five FDIC insured financial institutions failed, three of which are among the largest failures in U.S. history. The first failure was Silicon Valley Bank, Santa Clara, California, which failed on March 10, with $209 billion in assets, followed by Signature Bank, New York, New York, which failed on March 12, with $110.4 billion in assets, and First Republic Bank, San Francisco, California, which failed on May 1, with $212.6 billion in assets.

As of year-end, PLFCS had 25 permanent staff, 21 of whom worked primarily on professional liability matters and 4 of whom worked primarily on financial crimes matters. With regard to professional liability workload, there were 62 institutions in PLFCS's portfolio of matters[2] (32 of which were in its portfolio solely for collection purposes[3]), 24 pending professional liability lawsuits, open investigations in 75 claim areas out of 8 institutions, and 58 collection matters.[4] The following graph shows PLFCS's open professional liability investigations and lawsuits workload from 2007 through 2023.

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



<u>Conclusion</u>

During 2023, the FDIC's professional liability program continued to operate cost-effectively, recovering $40,751,738 and expending $18,631,515. Overall, from 1986 through the end of 2023, the program also remains cost-effective with total recoveries of $10.6 billion and total expenses of $2.5 billion.

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[2] All institutions in PLFCS's inventory are failed institutions, but an individual institution is considered "open" for professional liability program purposes while PLFCS is working on any professional liability matter relating to that failed institution. An "open investigation" is an investigation that has not yet been settled or otherwise resolved.

[3] Collection matters are those for which recoveries are obtained as a result of judgments, structured settlements, or claims submitted in bankruptcy proceedings, probate estates, or class action lawsuits.

[4] 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. The 11 categories of investigations are: (1) D&O, (2) MMF, (3) bond, (4) accountant, (5) attorney, (6) appraiser, (7) securities including RMBS, (8) financial instruments, (9) insurance/issuer, (10) digital assets/technology, and (11) other professional claims.

FDIC Federal Deposit Insurance Corporation

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES ($ MILLIONS)

	Recoveries*	In-House PLFCS Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses**	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
2023	$40.8	5.0	2.6	11.0	18.6	3.7:1	2.2:1
2022	$47.3	5.1	1.4	10.3	16.8	4.6 to 1	2.8 to 1
2021	$35.1	$4.9	$1.6	$18.9	$25.4	1.9 to 1	1.4 to 1
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	3.3 to 1	2.5 to 1
2017	$105.4	$8.8	$6.4	$48.4	$63.5	2.2 to 1	1.7 to 1
2016	$470.9	$9.2	$5.5	$58.8	$73.5	8.0 to 1	6.4 to 1
2015	$450.3	$12.1	$11.2	$73.1	$96.5	6.2 to 1	4.7 to 1
2014	$1,142.7	$13.3	$16.3	$90.1	$119.8	12.7 to 1	9.5 to 1
2013	$674.2	$13.5	$36.8	$94.2	$144.6	7.2 to 1	4.7 to 1
2012	$337.3	$12.6	$29.3	$68.1	$110.1	5.0 to 1	3.1 to 1
2011	$231.9	$12.0	$62.3	$64.7	$139.5	3.6 to 1	1.7 to 1
2010	$79.4	$10.1	$102.5	$47.2	$160.8	1.7 to 1	-0.5 to 1
2009	$47.1	$5.2	$35.9	$11.3	$52.9	4.2 to 1	-0.9 to 1
2008	$31.3	$2.0	$5.3	$2.4	$9.7	13.0 to 1	3.2 to 1
2007	$47.1	$2.0	$.7	$2.3	$5.0	20.5 to 1	9.4 to 1
2006	$34.5	$2.6	$.9	$3.7	$7.2	9.3 to 1	4.8 to 1
2005	$122.2	$3.4	$1.1	$3.9	$8.5	31.3 to 1	14.4 to 1
2004	$79.0	$4.0	$3.1	$9.0	$16.2	8.8 to 1	4.9 to 1
2003	$59.9	$3.5	$3.0	$13.7	$20.2	4.4 to 1	3.0 to 1
2002	$49.1	$3.2	$2.8	$13.1	$19.1	3.8 to 1	2.6 to 1
2001	$128.6	$3.4	$2.1	$10.5	$16.0	12.3 to 1	8.0 to 1
2000	$54.4	$4.0	$2.7	$14.0	$20.7	3.9 to 1	2.6 to 1
1999	$84.2	$5.8	$3.2	$17.4	$26.4	4.8 to 1	3.2 to 1
1998	$186.5	$5.8	$4.2	$21.9	$31.9	8.5 to 1	5.8 to 1
1997	$156.8	$7.8	$2.3	$29.1	$39.2	5.4 to 1	4.0 to 1
1996	$195.9	$15.8	$4.0	$48.1	$67.9	4.1 to 1	2.9 to 1
1995	$563.9	$14.0	$5.3	$98.1	$117.4	5.7 to 1	4.8 to 1
1994	$909.9	$17.7	$11.2	$135.5	$164.4	6.7 to 1	5.5 to 1
1993	$1,231.2	$18.4	$17.9	$187.3	$223.6	6.6 to 1	5.5 to 1
1992	$972.6	$15.7	$16.6	$179.3	$211.6	5.4 to 1	4.6 to 1
1991	$425.2	$11.7	$7.7	$183.7	$203.1	2.3 to 1	2.1 to 1
1990	$374.3	$6.1	$5.2	$94.8	$106.1	4.0 to 1	3.5 to 1

Federal Deposit Insurance Corporation

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES ($ MILLIONS)

	Recoveries*	In-House PLFCS Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses**	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
1989	$152.1	$4.5	$4.5	$32.0	$41.0	4.8 to 1	3.7 to 1
1988	$90.0	$1.4	$3.7	$20.8	$25.9	4.3 to 1	3.5 to 1
1987	$71.5	$1.1	$4.3	$15.2	$20.6	4.7 to 1	3.5 to 1
1986	$83.3	$1.0	$3.0	$10.9	$14.9	7.6 to 1	5.6 to 1
Total	$10,556.0	$288.0	$432.3	$1,808.0	$2,530.8	5.8 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 3) for all years before 1998 are staff compensation only (and exclude other direct costs). In-house expenses for all years shown exclude overhead.