



Federal Deposit Insurance Corporation

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Legal Division

February 21, 2017

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 2016

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 2016. 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 2016 PLU and DRR recovered \$470,939,393 and incurred expenses totaling \$73,546,805 for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries – 2016	
Securities		
Residential Mortgage-Backed Securities (“RMBS”)	\$253,176,465	(53.76%)
Other	\$10,185,515	(2.16%)
Director and Officer (“D&O”) Liability	\$105,926,269	(22.49%)
Mortgage Malpractice or Mortgage Fraud (“MMF”)	\$60,575,395	(12.86%)
Fidelity Bond	\$19,543,560	(4.15%)
Attorney Malpractice	\$11,530,000	(2.45%)
Insurance	\$5,000,000	(1.06%)
Accountant Malpractice	\$4,000,000	(0.85%)
Appraiser Malpractice	\$962,500	(0.20%)
Other	\$39,689	(0.01%)
TOTAL	\$470,939,393	(100.00%)

RMBS claims accounted for \$253,176,465 of the 2016 recoveries. Of this amount, \$190 million resulted from a settlement of claims for violations of state and federal securities laws in six lawsuits against eight underwriters of 21 Countrywide RMBS certificates sold to Colonial Bank (“Colonial”), Montgomery, Alabama, which failed on August 14, 2009; Franklin Bank, S.S.B. (“Franklin”), Houston, Texas, which failed on November 7, 2008; Guaranty Bank (“Guaranty”), Austin, Texas, which failed on August 21, 2009; Security Savings Bank (“SSB”), Henderson, Nevada, which failed on February 27, 2009; and Strategic Capital Bank (“Strategic”), Champaign, Illinois, which failed on May 22, 2009.¹

The \$105,926,269 in D&O liability recoveries came from claims out of 20 receiverships. The largest of these was from a \$26.5 million settlement with 18 former directors and officers of MidWest Bank & Trust (“MidWest”), Elmwood Park, Illinois. The FDIC’s claims against the defendants were based on their negligence, gross negligence, and breaches of fiduciary duties in connection with the approvals of 12 loans and the defendants’ failure to divest Fannie Mae and Freddie Mac preferred stock after MidWest had classified the stock as other-than-temporarily-impaired. MidWest failed on May 14, 2010, with \$3.2 billion in assets.

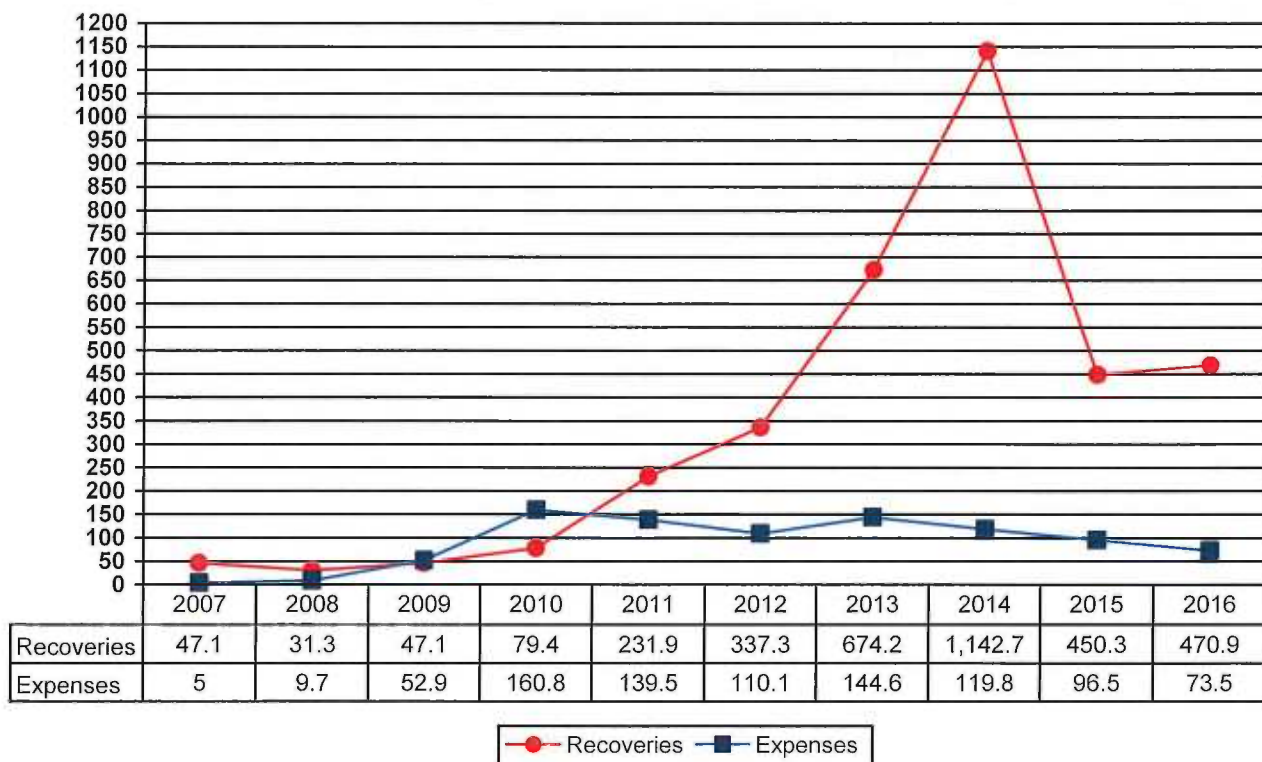
Of the total program expenses of \$73,546,805 incurred during 2016, the Legal Division incurred \$68,007,965 (92.47 percent), DRR incurred \$5,499,455 (7.48 percent), and other FDIC Divisions and Offices incurred \$39,385 (0.05 percent). Legal Division expenses comprise \$58,844,148 paid to outside counsel and consultants and \$9,163,817 for other expenses (primarily salaries and travel expenses for in-house PLU employees). DRR expenses comprise \$1,274,217 paid to outside contractors and \$4,225,238 for in-house staff. The ratio of total recoveries to total expenses is 6.4 to 1, and the ratio of recoveries to outside counsel and consultant expenses only is 8 to 1.

Professional liability program expenses during 2016 are attributable primarily to the substantial receivership funding expenses that the Legal Division and DRR continue to incur to conduct professional liability investigations and litigation arising from the large number of

¹ The settling underwriters were: Barclays Capital Inc.; BNP Paribas Securities Corporation; Credit Suisse Securities (USA) LLC; Deutsche Bank Securities Inc.; Edward D. Jones & Co., L.P.; Goldman, Sachs & Co; RBS Securities Inc.; and UBS Securities LLC.

insured financial institutions that failed since the beginning of 2007. Typically, program expenses are incurred several years before associated recoveries are received because 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, 2007-2016 (in \$millions)



As shown in the historical table attached at the end of this report, from 1986 through 2016 the professional liability program has achieved an overall recoveries-to-expenses ratio of 4.12 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 \$3.512 billion and incurred expenses totaling \$912.4 million for all professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Total Recoveries – 2007-2016
Securities	
RMBS	\$1,675,560,757 (47.70%)
Other	\$59,486,505 (1.69%)
D&O Liability	\$1,231,932,081 (35.07%)
MMF	\$216,621,035 (6.17%)
Fidelity Bond	\$144,910,203 (4.13%)
Accountant Malpractice	\$50,834,317 (1.45%)
Appraiser Malpractice	\$45,738,132 (1.30%)
Attorney Malpractice	\$40,799,157 (1.16%)
Other	\$34,196,025 (0.97%)
Insurance	\$12,263,836 (0.35%)
TOTAL	\$3,512,342,047 (100.00%)

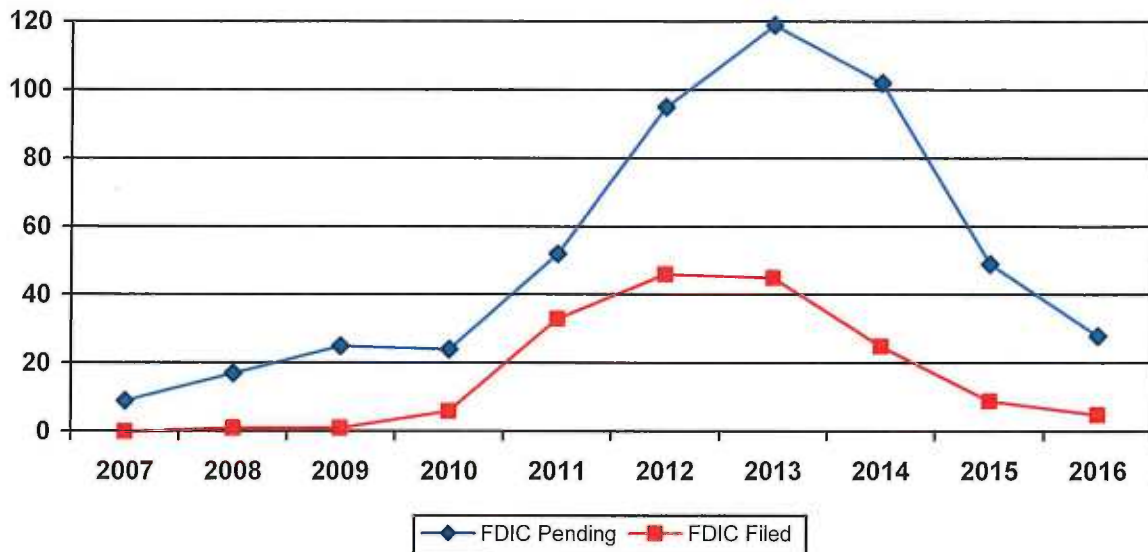
Authorized and Pending Lawsuits

During 2016 PLU obtained authority from the FDIC Board of Directors to sue six D&O defendants out of First United Bank (“First United”), Crete, Illinois, for their negligence, gross negligence, and breaches of fiduciary duty in approving 10 loans in violation of First United’s loan policy and prudent lending practices. PLU filed suit against the directors and officers on June 15 in the United States District Court for the Northern District of Illinois. First United failed on September 28, 2012, with \$328.4 million in assets. In addition, the FDIC authorized three other lawsuits for fidelity bond claims and authorized the addition of the FDIC as Receiver for Doral Bank to the already pending U.S. Dollar (“USD”) London Interbank Offered Rate (“LIBOR”) lawsuit. PLU subsequently filed suit in connection with all but one of these matters; the fourth matter was resolved pre-suit.

In 2016 PLU filed five lawsuits other than MMF lawsuits. As of year-end, a total of 28 professional liability lawsuits other than MMF lawsuits were pending. PLU also had 42 active MMF lawsuits pending at the end of 2016. These arise out of six failed institutions but primarily from AmTrust Bank, Cleveland, Ohio, which failed on December 4, 2009 (29). The remaining 13 MMF lawsuits are associated with five other failed institutions around the country.

The following graph shows pending professional liability civil cases (other than MMF lawsuits) from 2001 through year-end 2016. (“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, 2007-2016
(Excludes MMF and related-to-PL matters such as individual bankruptcy cases)



Significant Case Developments During 2016

During the year, PLU tried two D&O liability cases, both to successful conclusions. The first trial arose out of the negligence and gross negligence of eight former directors and officers of The Buckhead Community Bank (“Buckhead”), Atlanta, Georgia, in recommending and approving 10 poorly underwritten loans that resulted in \$17 million in losses to Buckhead. After an eight-day trial in the United States District Court for the Northern District of Georgia, on October 25 a jury found the defendants jointly and severally liable for \$4,986,993 in losses from 4 of the 10 loans. A ninth defendant’s estate paid the FDIC \$375,000 to settle claims against him before trial. Buckhead failed on December 4, 2009, with \$856.2 million in assets.

The second trial arose out of the negligence, gross negligence, and breaches of fiduciary duty of 10 former directors and officers of Butte Community Bank (“Butte”), Chico, California, in approving an \$8.8 million dividend to Butte’s holding company in May 2008 that was used to repurchase shares of stock from the defendants and other shareholders of Butte’s holding company. The defendants personally received \$3.4 million in the stock repurchase. On November 17, after an 11-day trial in the United States District Court for the Eastern District of California, a jury found the defendants jointly and severally liable for losses resulting from their negligence in approving the dividend, and the jury returned a verdict of \$3.52 million in favor of the FDIC. The jury denied recovery on the FDIC’s claims for gross negligence and breach of the fiduciary duty of loyalty. Butte failed on August 20, 2010, with \$499 million in assets.

During 2016 PLU continued to pursue state and federal securities law claims in seven RMBS cases out of five receiverships: Guaranty (2 cases); United Western Bank (“UWB”), Denver, Colorado (1 case); Colonial (3 cases); and a combined case for sister banks, Strategic and Citizens National Bank (“Citizens”), Macomb, Illinois. The two Guaranty cases and the UWB case are in discovery with trial dates set for the Guaranty cases in January and March 2018. Fact discovery in two of the three Colonial cases has concluded, and trials are set to begin

by September 2017. In the third Colonial case, the United States Court of Appeals for the Second Circuit (“Second Circuit”) ruled on May 19 that the FDIC’s “extender” statute of limitations, 12 U.S.C. § 1821(d)(14), displaces all other limitations periods, including statutes of repose. Defendants unsuccessfully petitioned the Second Circuit for *en banc* review of the decision and then sought review by the United States Supreme Court.² The combined Strategic and Citizens case was on appeal before the Second Circuit regarding the same issue that was decided in the Colonial case on May 19 and oral argument was held on November 8.³

During 2016 the United States District Court for the Southern District of New York granted defendants’ joint motion to dismiss, for lack of standing, the FDIC’s claims in three separate lawsuits against The Bank of New York Mellon, U.S. Bank N.A., and Citibank, N.A., as trustees of 15 RMBS that Guaranty purchased. In this lawsuit, the FDIC alleges that the defendants failed to enforce rights under the governing trust agreements to protect the quality of the collateral loans underlying the RMBS in the trusts at issue, thereby breaching their contracts and violating their statutory obligations as trustees. The court held that when, in 2010, the FDIC resecuritized and sold the RMBS, it also sold any claims against the trustees for those RMBS and lost standing to pursue the claims. The court dismissed the FDIC’s claims without prejudice. Staff’s motion for reconsideration, filed on October 14, was pending at year-end.

During 2016 the United States District Court for the Southern District of New York issued two significant rulings on motions to dismiss in the USD LIBOR multidistrict litigation (“MDL”). In its LIBOR case that’s part of this MDL, the FDIC alleges that the suppression of USD LIBOR by 31 banks and bank affiliates and three British Bankers’ Association entities caused 38 FDIC-insured banks that later failed to receive smaller payments on loans and other assets linked to USD LIBOR than they otherwise would have. The FDIC’s claims are based on state tort and contract law theories and federal and state antitrust laws. On September 12, in an order clarifying several of its previous rulings, the court held that the FDIC has adequately pled fraud-by-omission claims against certain defendants and that the FDIC’s claims against Royal Bank of Canada for implied breach of contract are not time-barred. The court, however, denied the FDIC’s request for jurisdictional discovery and clarified that, for the FDIC’s aiding and abetting claims, it lacks personal jurisdiction over any defendants based outside of the United States. On December 21, the court issued its sixth omnibus order in the MDL in which it granted in part and denied in part the defendants’ motions to dismiss antitrust and conspiracy claims that the FDIC and other plaintiffs had filed. The court held that the FDIC has standing to pursue its antitrust claims against defendants based in the United States on the ground that the FDIC is an efficient enforcer of the antitrust laws, but the court again held that the court lacks personal jurisdiction over defendants based outside of the United States.

With most challenges to D&O insurance coverage for FDIC claims successfully resolved prior to 2016, only 14 D&O cases remained pending at the beginning of 2016. During the year, courts issued four additional insurance coverage rulings favorable to the FDIC. First, in March, the United States District Court for the Northern District of Georgia ruled that an insurer could

² After year end, on January 9, the United States Supreme Court denied defendants’ petition for certiorari, leaving undisturbed the May 19 panel decision that the FDIC’s RMBS claims are not time-barred.

³ On January 18 the Second Circuit reversed the dismissal and remanded the case.

not assert a regulatory exclusion as a bar to coverage because the insurer had added the exclusion to the bank's policy after the bank had failed, which violated the FDI Act, 12 U.S.C. §§ 1821(d)(8)(A) and 1823(e). In a second case, the United States District Court for Puerto Rico ruled in August that neither an insured v. insured exclusion nor a professional services exclusion precluded coverage for the FDIC's claims. In September, the United States District Court for the Northern District of Georgia issued a third decision ruling that neither an interrelated wrongful acts exclusion nor an insured v. insured exclusion barred coverage for claims by the FDIC as receiver. The insurer appealed the lower court's determination to the U.S. Court of Appeals for the Eleventh Circuit, where it remains pending. Finally, in October, the U.S. Court of Appeals for the Ninth Circuit ("Ninth Circuit"), in an unpublished opinion, affirmed the lower court's ruling that neither an insured v. insured exclusion nor an unpaid loan carve-out to the definition of "Loss" precludes coverage for the FDIC's claims.

In the one unfavorable D&O insurance coverage decision during 2016, the Oklahoma state court overseeing the liquidation proceedings of Red Rock Insurance Company (formerly BancInsure, Inc. ("BancInsure")) disallowed 5 of the FDIC's 10 pending proofs of claim out of five failed banks. The court relied on a 2015 ruling from the U.S. Court of Appeals for the Tenth Circuit, which held that the unique form of the insured v. insured exclusion in BancInsure's policies precludes coverage for the FDIC as Receiver's claims. The BancInsure insured v. insured exclusion, unlike similar exclusions in other D&O insurance policies, explicitly excludes coverage for claims brought by or on behalf of a "receiver." The Oklahoma court, however, also held that the remaining five proofs of claim would be held in abeyance pending a final decision in the Ninth Circuit's appellate proceedings in two BancInsure cases.

PLU Workload and Staffing at Year-End

During 2016 five FDIC-insured financial institutions failed. The largest institution to fail was First CornerStone Bank, King of Prussia, Pennsylvania, which failed on May 6 with \$138.5 million in assets. These five failures brought total institution failures since the beginning of 2007 to 523. These 523 failures on average were relatively large in size since their assets at failure totaled \$698.73 billion.⁴

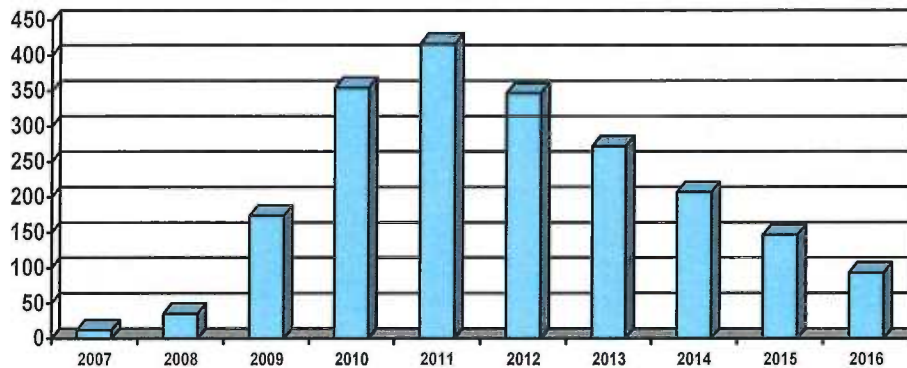
Given their large average size and complexity, these 523 failures since 2007 resulted in a very substantial increase in PLU's workload beginning in 2008. Even though the rate of institution failures continued to decline in 2016, PLU's overall workload, as measured by five workload drivers and accounting, in particular, for the substantial work required to manage its active litigation caseload, was still heavy during 2016. As in 2015, the nature of PLU's workload in 2016 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.⁵ As of September 1, 2007, PLU had 49 open institutions in its inventory (39

⁴ The average asset size of these 523 failed institutions is \$1.3 billion. Even excluding Washington Mutual Bank, Henderson, Nevada, which failed in 2008 with \$307 billion in assets, the average asset size of the 522 remaining failed institutions is \$757.67 million.

⁵ 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

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 collection matters.⁶ As of year-end 2016, PLU had 126 open institutions, 33 of which are open for collection only, 28 pending professional liability lawsuits, 1 additional related lawsuit, 42 MMF lawsuits, 173 open investigations,⁷ and 67 active collection matters.

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



To handle the increased workload, PLU’s staff increased substantially starting in the second half of 2008 and, since 2011 has been decreasing. 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 2016, PLU had 36 total staff in two offices – Virginia Square and the Dallas Regional Office.

Conclusion

During 2016 the FDIC’s professional liability program continued to operate cost-effectively recovering a total of \$470,939,393 and incurring total expenses of \$73,546,805 as PLU and DRR continued to devote substantial resources to the professional liability investigations and litigation cases arising from the 523 failures that have occurred since the beginning of 2007 through 2016.

(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.

⁶ 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.

⁷ 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 ⁸	In-House PLU Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses ⁹	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
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	\$7.0	\$2.3	\$5.0	20.62 to 1	9.40 to 1
2006	\$34.5	\$2.6	\$9.0	\$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	\$9,537.3	\$242.9	\$414.6	\$1,654.2	\$2,314.3	5.77 to 1	4.12 to 1

⁸ Recoveries comprise all FDIC, RTC, and FSLIC recoveries, including RTC and FDIC Drexel-Milken recoveries of \$1.143 billion.

⁹ 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.