



February 20, 2018

MEMORANDUM TO: Board of Directors

THROUGH: Charles Yi
General Counsel

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

SUBJECT: Professional Liability Program Annual Report for 2017

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 2017. 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 2017 PLU and DRR recovered \$105,417,397 and incurred expenses totaling \$63,549,552 for professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Recoveries – 2017	
Director and Officer (“D&O”) Liability	\$35,646,900	(33.82%)
Fidelity Bond	\$31,601,355	(29.98%)
Securities		
Residential Mortgage-Backed Securities (“RMBS”)	\$20,572,633	(19.52%)
Other	\$1,695,536	(1.61%)
Mortgage Malpractice or Mortgage Fraud (“MMF”)	\$12,046,933	(11.43%)
Accountant Malpractice	\$2,050,000	(1.94%)
Attorney Malpractice	\$1,500,000	(1.42%)
Other	\$204,040	(0.19%)
Insurance	\$100,000	(0.09%)
TOTAL	\$105,417,397	(100.00%)

The \$35.6 million in D&O liability recoveries came from claims out of eight receiverships. The largest of these was a \$14 million pre-suit settlement of claims against two former officers of Doral Bank (“Doral”), San Juan, Puerto Rico. The FDIC’s claims were based on the officers’ gross negligence in failing to ensure that Doral collected contractually agreed mortgage servicing fees from its holding company and in approving servicing advances. Doral failed on February 27, 2015, with \$5.9 billion in assets.

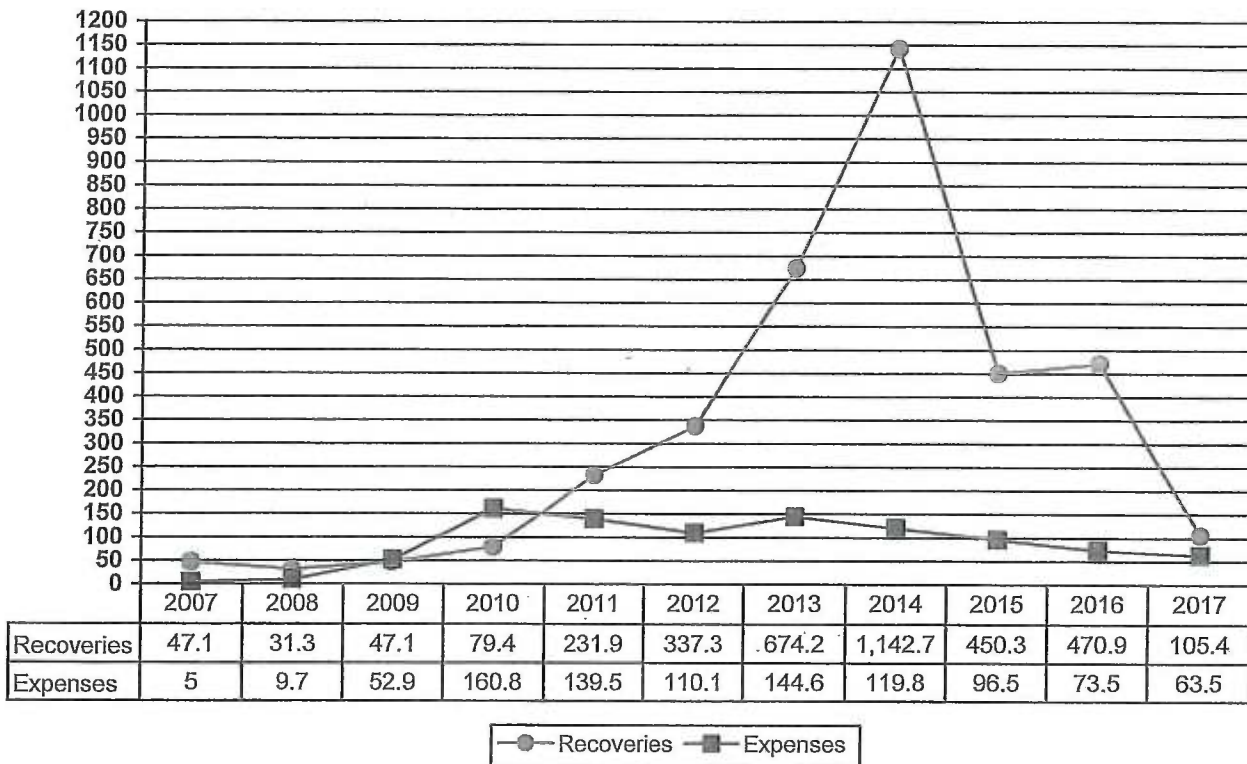
The \$31.6 million in fidelity bond recoveries resulted from claims out of nine receiverships. The largest of these was a \$19.75 million recovery out of R-G Premier Bank of Puerto Rico (“R-G”), Hato Rey, Puerto Rico. The FDIC’s claim was based on the fidelity bond carrier’s breach of contract in failing to pay \$25 million in covered losses under the bond. The losses resulted from the fraud and dishonesty of Victor Irizarry, R-G’s former Chief Lending Officer and Executive Vice President of Corporate Banking, in connection with 12 loans. R-G failed on April 30, 2010, with \$5.7 billion in assets.

Of the total program expenses of \$63,549,552 incurred during 2017, the Legal Division incurred \$57,176,581 (89.97 percent), DRR incurred \$6,350,829 (9.99 percent), and other FDIC Divisions and Offices incurred \$22,142 (0.03 percent). Legal Division expenses comprise \$48,373,697 paid to outside counsel and consultants and \$8,802,884 for other expenses (primarily salaries and travel expenses for in-house PLU employees). DRR expenses comprise \$2,576,371 paid to outside contractors and \$3,774,458 for in-house staff. The ratio of total recoveries to total expenses is 1.7 to 1, and the ratio of recoveries to outside counsel and consultant expenses only is 2.2 to 1.

Professional liability program expenses during 2017 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 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, 2007-2017 (in \$millions)



As shown in the historical table attached at the end of this report, from 1986 through 2017 the professional liability program has achieved an overall recoveries-to-expenses ratio of 4.06 to 1.

Report on Total Recoveries and Expenses From 2007 Through 2017

Because recoveries and expenses during 2017 are primarily attributable to claims arising from institutions that failed during the recent failing institution crisis from 2008 through 2014, it is useful to view 2017's results in the context of results to date out of all institutions that failed during the crisis. Since the beginning of 2007, PLU and DRR have recovered \$3.618 billion and incurred expenses totaling \$975.9 million for all professional liability program activity. The recoveries were obtained from the following types of claims:

Type of Claim	Total Recoveries = 2007-2017	
Securities		
RMBS	\$1,696,133,390	(46.88%)
Other	\$61,182,041	(1.69%)
D&O Liability	\$1,267,578,981	(35.04%)
MMF	\$228,667,968	(6.32%)
Fidelity Bond	\$176,511,558	(4.88%)
Accountant Malpractice	\$52,884,317	(1.46%)
Appraiser Malpractice	\$45,738,132	(1.26%)
Attorney Malpractice	\$42,299,157	(1.17%)
Other	\$34,400,065	(0.95%)
Insurance	\$12,363,836	(0.34%)
TOTAL	\$3,617,759,445	(100.00%)

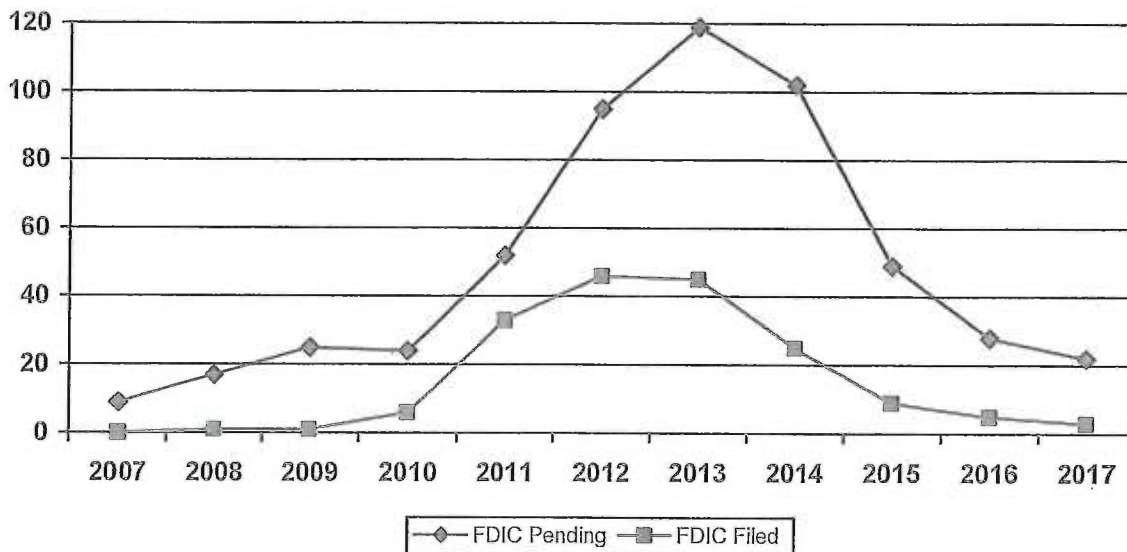
Authorized Lawsuits During 2017 and Pending Lawsuits Year-End

During 2017 PLU obtained authority from the FDIC Board of Directors to sue three directors and officers out of Valley Bank (“Valley”) Moline, Illinois, for their negligence, gross negligence, and breaches of fiduciary duty in approving loans and failing to supervise Valley’s lending function. PLU settled the D&O claims pre-suit for \$3.025 million on June 30. Also in connection with Valley, PLU obtained authority to sue Crowe Horwath LLP (“Crowe”) for accounting malpractice. On June 9, the FDIC filed a lawsuit against Crowe in the U.S. District Court for the Northern District of Illinois, which remains pending. Valley failed on June 20, 2014, with \$456.4 million in assets.

In 2017 PLU filed two additional lawsuits: a fidelity bond lawsuit and one lawsuit filed in London, England, based on defendants’ suppression of the U.S. Dollar London Interbank Offered Rate (“USD LIBOR”). As of year-end, a total of 22 professional liability lawsuits (not including MMF) lawsuits were pending. PLU also had 21 active MMF lawsuits pending at the end of 2017.

The following graph shows pending professional liability civil cases (other than MMF lawsuits) from 2007 through year-end 2017. (“Pending” actions include claims that PLU itself filed as well as claims that institutions filed before they failed, which the FDIC inherited as Receiver.)

FDIC Professional Liability Civil Actions, 2007-2017
(Excludes MMF and Other PL-Related Matters Such as Individual Bankruptcy Cases)



Significant Case Developments During 2017

In March 2017 the FDIC as Receiver for 39 failed banks filed a lawsuit in the High Court of Justice in London, England, asserting claims against entities of seven foreign banks and the British Bankers Association based on their suppression of USD LIBOR. The United States District Court for the Southern District of New York previously had dismissed those foreign defendants from a separate lawsuit that the FDIC had filed in the United States in New York City federal court in 2014 against 34 defendants for lack of personal jurisdiction. In both lawsuits, the FDIC alleges that the defendants' suppression of USD LIBOR caused the failed banks to receive smaller payments on loans and other assets linked to USD LIBOR than they otherwise would have received. In the London case, the FDIC asserts claims under the United Kingdom's competition law and the tort laws of applicable U.S. states. In the U.S. case, the FDIC asserts claims under state tort and contract laws and federal and state antitrust laws. The London case is in the initial pleadings stage, and the U.S. case is currently stayed pending resolution of class certification issues in separate LIBOR class action lawsuits that are also before the court. No discovery or trial schedule has been set yet in either case.

On December 28, following a four-week bench trial, the United States District Court for the Middle District of Alabama issued an order in favor of the FDIC as Receiver for Colonial Bank ("Colonial"), Montgomery, Alabama, in the liability phase of an accounting malpractice lawsuit against PricewaterhouseCoopers, LLP ("PwC"). The FDIC alleged that PwC breached its professional duties to Colonial and thereby failed to detect a massive fraud perpetrated on Colonial by its largest customer, a mortgage originator named Taylor Bean & Whitaker Mortgage Corporation, resulting in over \$1 billion in losses to Colonial. The court held, among other things, that PwC committed professional negligence by failing to design its audits to detect fraud and by failing to obtain sufficient competent evidence to sign its unqualified audit reports relating to PwC's consolidated audits of Colonial and its holding company, Colonial Bancgroup, Inc. ("CBG"). In the same order, the court concluded that, although PwC breached its

professional duties to CBG, the affirmative defenses of audit interference, *in pari delicto* (equal in fault), and the *Hinkle* rule (specifying that a plaintiff may not maintain an action if, in order to establish it, he/she must rely on an illegal act or transaction to which he/she is a party) bar CBG from recovering on its claims. The court had issued an earlier order holding that these same defenses are not available against the FDIC as Receiver. The second phase of the PwC bench trial on damages is scheduled to begin in March 2018. Colonial failed on August 14, 2009, with \$25.5 billion in assets.

During 2017, after a nearly four week trial, on September 14 a jury in the U.S. District Court for the Northern District of Illinois returned a verdict of \$1.45 million in favor of the FDIC as Receiver for Founders Bank (“Founders”) in its MMF lawsuit against Chicago Title Insurance Company (“CTIC”). The jury found that CTIC was liable on all counts, including breach of contract, breach of fiduciary duty, negligence, and negligent misrepresentation, and that CTIC’s actions were willful and wanton. CTIC acted as closing agent for same day double closings for four separate residential real estate transactions in 2006, but it failed to disclose to Founders that for each transaction, a lower-priced sale occurred first or that the later, higher-priced sale funded the required 20 percent down payments on the transactions. The court has not yet entered judgment. Post-trial briefing is anticipated in 2018. Founders failed on July 2, 2009, with \$889.2 million in assets.

PLU in 2017 continued to pursue state and federal securities law claims in seven RMBS cases out of five receiverships. Two cases out of Guaranty Bank, Austin, Texas, are in the final phases of discovery, with trials scheduled in July 2018 and March 2019. Discovery in three of the remaining cases is largely concluded, and discovery in the other two cases is in the early stages. None of these cases, however, has a scheduled trial date.

PLU Workload and Staffing at Year-End

During 2017 eight FDIC-insured financial institutions failed. The largest institution to fail was First NBC Bank, New Orleans, Louisiana, which failed on April 28 with \$3.3 billion in assets. These eight failures brought total institution failures since the beginning of 2007 to 531. These 531 failures on average were relatively large in size, with total assets at failure totaling \$704.18 billion.¹

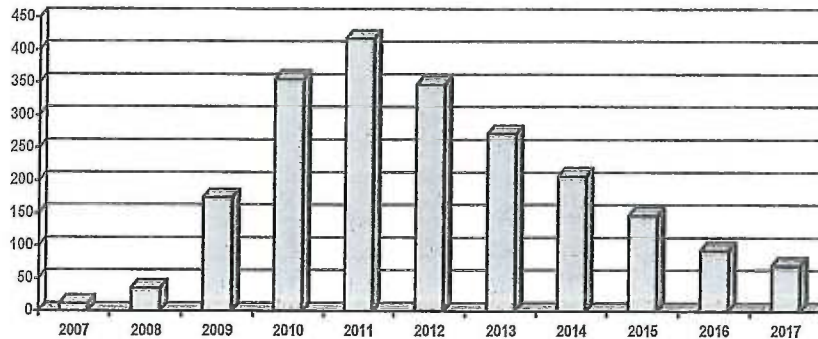
Given their large average size and complexity, the 531 failures since 2007 resulted in a very substantial increase in PLU’s workload beginning in 2008, which peaked during 2011 and 2012. Although PLU’s workload has declined significantly since then, its workload remained elevated during 2017, with a primary focus on large litigation cases and large-scale investigations. 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.² As of

¹ The average asset size of these 531 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 530 remaining failed institutions is \$749.39 million.

² 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.

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 open investigations, and 95 active collection matters.³ As of year-end 2017, PLU had 101 open institutions, 31 of which are open for collection only, 22 pending professional liability lawsuits, 2 additional related lawsuits, 21 MMF lawsuits, 164 open investigations,⁴ and 56 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, peaked in 2011, and has been decreasing since then. 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 and managers located in two permanent and three temporary satellite offices. As of year-end 2017, PLU had 29 total staff all in the two permanent offices – Virginia Square and the Dallas Regional Office.

Conclusion

During 2017 the FDIC’s professional liability program continued to operate cost-effectively recovering a total of \$105,417,397 and incurring total expenses of \$63,549,552 as PLU and DRR continued to devote substantial resources to the professional liability investigations and litigation cases arising from the 531 failures that have occurred since the beginning of 2007 through 2017.

³ 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.

⁴ 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 or otherwise resolves 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 resolved.

FDIC PROFESSIONAL LIABILITY RECOVERIES AND EXPENSES (\$ MILLIONS)

	Recoveries ⁵	In-House PLU Expenses	DRR Expenses	Outside Counsel Expenses	Total Expenses ⁶	Ratio of Recoveries to Outside Counsel Expenses	Ratio of Recoveries to Total Expenses
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	\$9,642.7	\$251.7	\$421.0	\$1,702.6	\$2,377.9	5.66 to 1	4.06 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 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.