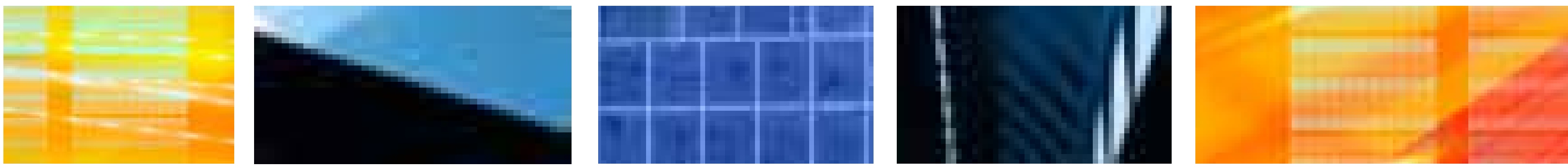
Characteristics of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions



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CORNERSTONE RESEARCH

Characteristics of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions

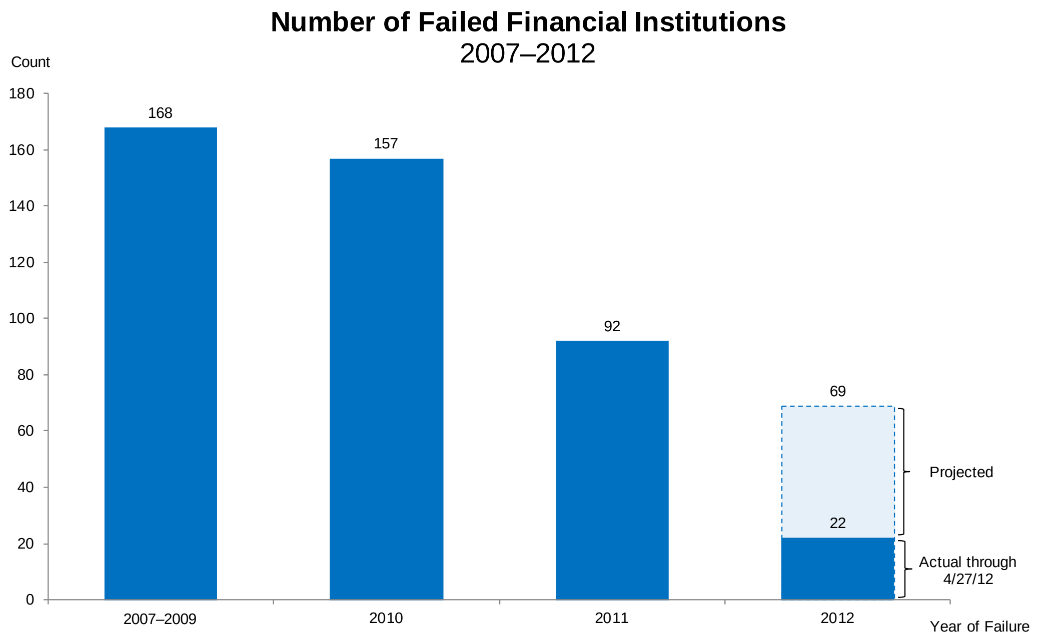
By Abe Chernin, Catherine J. Galley, Yesim C. Richardson and Joseph T. Schertler

This is the second in a series of articles that examines statistics and offers commentary on the characteristics of professional liability lawsuits filed to date by the Federal Deposit Insurance Corporation against directors and officers of failed financial institutions. Since our previous article, eight lawsuits have been filed related to eight failed financial institutions. Lawsuits may also be filed by the FDIC against other related parties, such as accounting firms, law firms, appraisal firms or mortgage brokers, but we do not address these here.

Overview

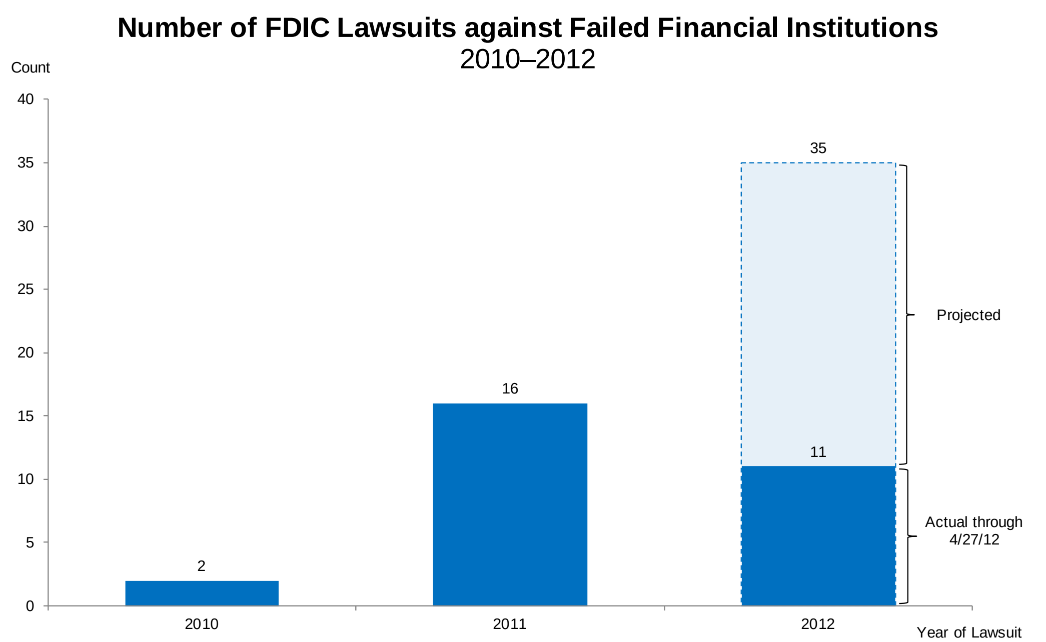
Seizures of banks and thrifts by regulatory authorities have subsided in 2012 relative to the levels in 2011 and 2010. From January through late-April 2012, 22 financial institutions have been seized. If the current pace of seizures continues throughout the year, 69 financial institutions will be seized in 2012, compared to 92 seizures in 2011 and 157 seizures in 2010. In contrast, the FDIC has been intensifying its litigation activity associated with failed financial institutions, filing 11 lawsuits through late-April 2012, compared with 16 lawsuits in all of 2011. If filings continue at the current pace, an additional 24 lawsuits will be filed this year.

Overall, from July 2, 2010, through April 20, 2012, the FDIC filed 29 lawsuits against directors and officers of 28 failed institutions. As we observed previously, these lawsuits continued to target the officers and directors of financial institutions that had a large asset base and a high estimated cost of failure. Aggregate damages claimed in the complaints totaled $2.4 billion and were typically based on losses related to commercial real estate (CRE) lending, and acquisition, development and construction (ADC) lending.



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html).

Note:
1. Financial institutions include commercial banks, savings banks, and savings and loans (thrifts).
2. Failed institutions are financial institutions that have failed since January 1, 2007. For 2012, data for failed institutions are through April 16, 2012. Projected numbers for 2012 assume institutions will fail at the same rate observed between January 1, 2012, and April 27, 2012.

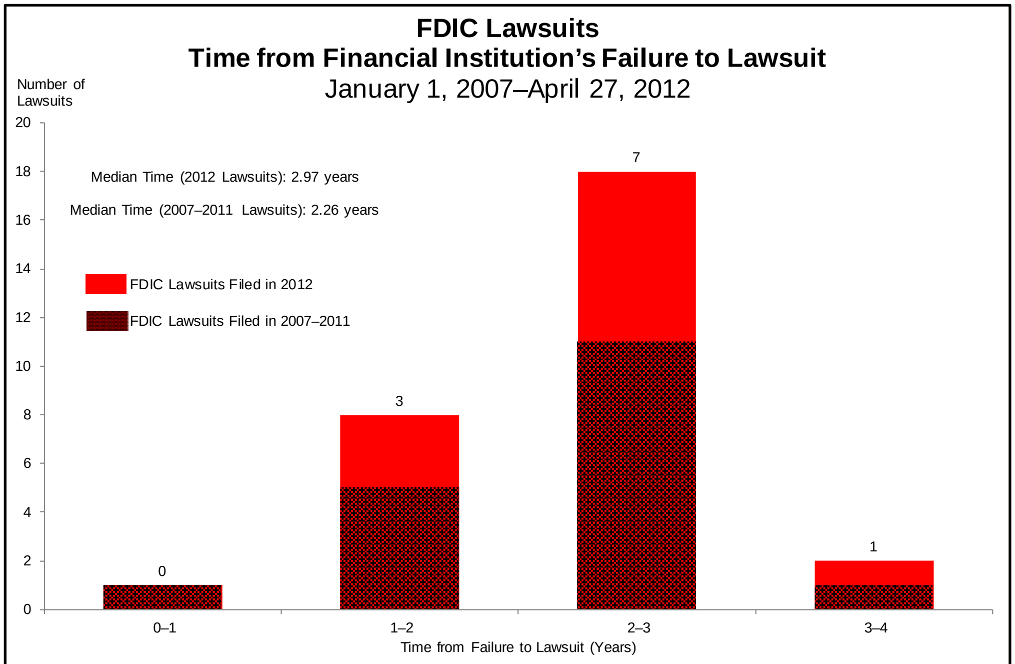


Source: FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/).

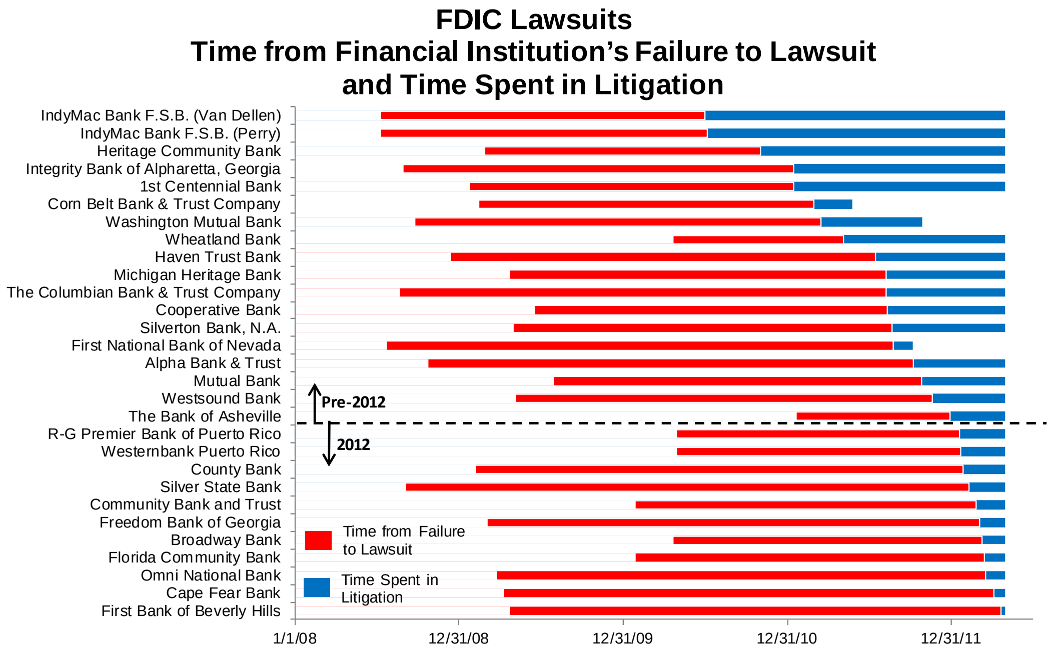
Note:
1. Financial institutions include commercial banks, savings banks, and savings and loans (thrifts).
2. The FDIC has released information about lawsuits it filed between January 1, 2007, and April 27, 2012. Projected numbers for 2012 assume that the FDIC will file lawsuits at the same rate observed between January 1, 2012, and April 27, 2012.

Characteristics

While the pace of lawsuit filings has increased in 2012, the FDIC has not increased the time it takes to file a lawsuit following a failure. The median time between an institution's failure and the filing of an FDIC lawsuit was 2.97 years for 2012, compared with 2.26 years for 2007 through 2011. The most recent lawsuits have been filed just prior to, what we understand is, the three-year statute of limitations. Among the 11 lawsuits that have been filed in 2012, five concern financial institutions that failed in 2010, five that failed in 2009 and one that failed in 2008.



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), and FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/).



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), and FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/).

Note: Financial institutions are ordered based on their date of lawsuit. Lawsuits with respect to Corn Belt Bank & Trust Company, Washington Mutual Bank and First National Bank of Nevada have settled.

To date, 6 percent of financial institutions that have failed since 2007 have been the subject of FDIC lawsuits. These lawsuits generally have targeted larger failed institutions and those with a higher estimated cost of failure. The 28 financial institutions targeted in lawsuits had median total assets of $973 million, compared with median total assets of approximately $241 million for all failed institutions. Six of these institutions had total assets of more than $3 billion. An additional seven had total assets between $1 billion and $3 billion. None had assets less than $100 million. The median size of the 28 institutions was approximately four times as large as the median size of all failed institutions and six times as large as the median size of currently active institutions. Furthermore, the median asset size of the institutions targeted by lawsuits filed in 2012 was $447 million larger than the median asset size of the institutions targeted in earlier lawsuits.

The 28 institutions targeted in lawsuits had a median estimated cost to the FDIC of $222 million at the time of seizure. This compares with the median estimated cost of failure of $59 million for all failed financial institutions. The financial institutions subject to lawsuits thus far in 2012 have had higher estimated failure costs than previously sued institutions. The median cost of failure for financial institutions that have been targeted in 2012 lawsuits was $355 million, compared with $158 million for institutions sued from 2007 through 2011.

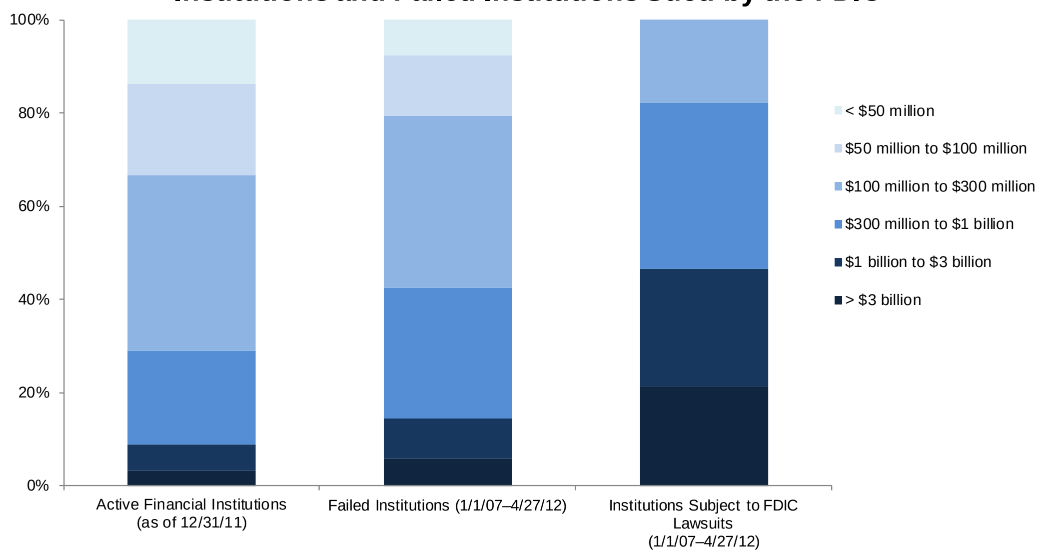
Comparison of Asset Size and Failure Cost
All Financial Institutions with Those That Failed and Those Subject to FDIC Lawsuits

	Number of Institutions	Median Total Assets (Millions)	Median Cost of Failure (Millions)
Institutions Subject to FDIC Lawsuits			
Filed between 1/1/07 and 12/31/11	17	$735.07	$158.10
Filed between 1/1/12 and 4/27/12	11	$1,181.72	$354.50
All Institutions	28	$973.18	$222.00
Failed Institutions (1/1/07–4/27/12)	439	$240.51	$59.10
Active Financial Institutions (as of 12/31/11)	7,426	$157.64	N.A.

Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Financial institutions include commercial banks, savings banks, and savings and loans (thrifts).
2. Total assets as of the last reporting period prior to seizure by the FDIC.
3. Institutions that are the subject of multiple FDIC lawsuits are counted only once.
4. Cost of failure is the FDIC's estimate of the cost to the DIF (Deposit Insurance Fund) at the time of seizure of the failed institution, when available. Otherwise, the cost of failure is based on FDIC estimates from December 31, 2010.

Distribution of Total Asset Size
Comparison Between Active Financial Institutions, Failed Institutions and Failed Institutions Sued by the FDIC



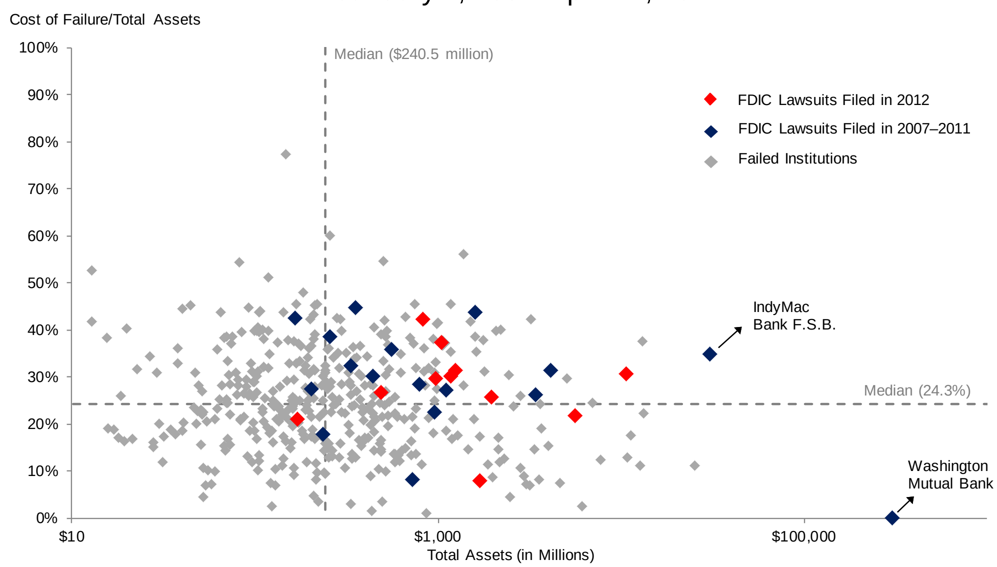
Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Financial institutions include commercial banks, savings banks, and savings and loans (thrifts).
2. Institutions that are the subject of multiple FDIC lawsuits are counted only once.

The FDIC lawsuits to date have included those related to the two largest failed institutions (Washington Mutual and IndyMac). The lawsuits filed in 2012 include two other institutions (Westernbank Puerto Rico and R-G Premier Bank of Puerto Rico) that are among the 15 largest failures. Other large or costly failures, including many of the most costly failures that occurred in 2008, have not yet been the target of FDIC lawsuits. One reason these costly early failures have yet to be involved in an FDIC lawsuit may be that the directors and officers of these institutions are involved in negotiations with the FDIC over any potential lawsuits. Whether additional 2008 failures will become the target of future FDIC lawsuits will depend on the outcome of such negotiations, statute of limitations restrictions, and tolling agreements that may be agreed upon during such negotiations.

Cost of Failure and Asset Size for Failed Financial Institutions

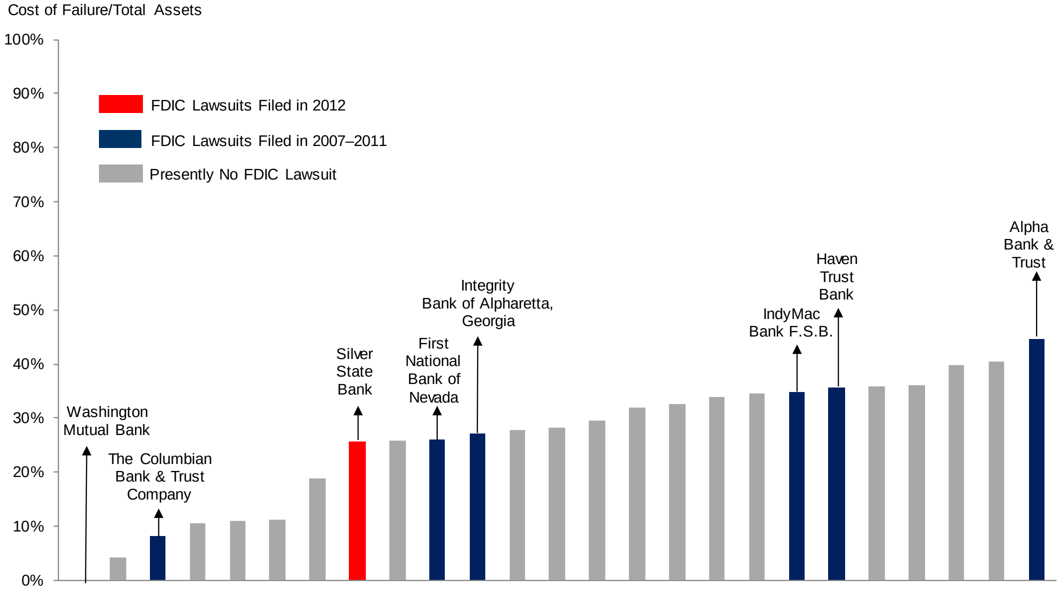
January 1, 2007–April 27, 2012



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Historical Statistics on Banking (http://www2.fdic.gov/hsob/index.asp), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Total assets as of last reporting period prior to seizure by the FDIC. Presented on a logarithmic scale.
2. Cost of failure is the FDIC's estimate of the cost to the DIF (Deposit Insurance Fund) at the time of seizure of the failed institution, when available. Otherwise, the cost of failure is based on FDIC estimates from December 31, 2010.

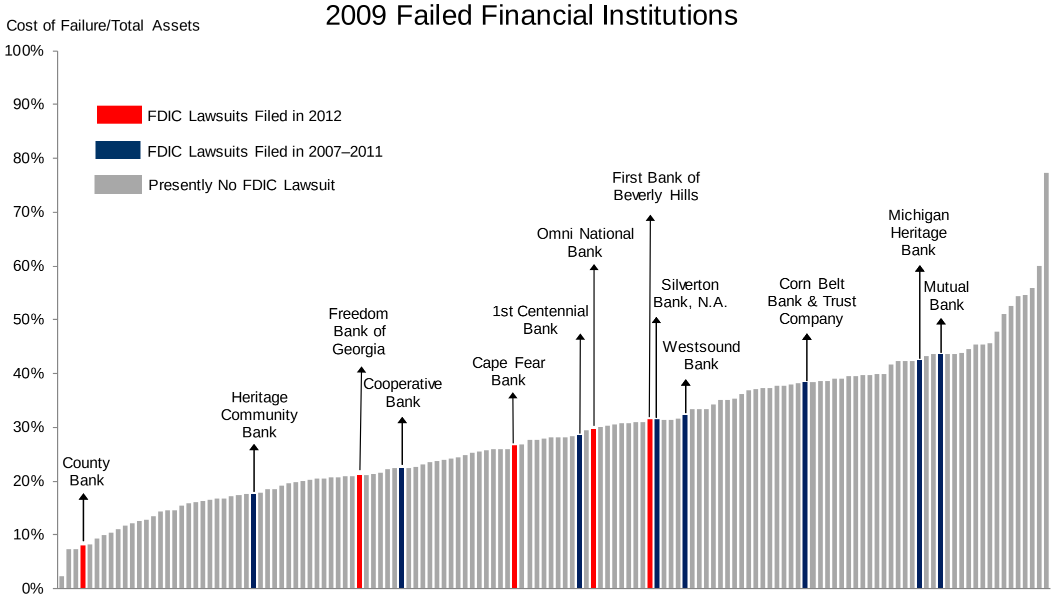
Cost of Failure for Financial Institutions per Dollar of Assets
2008 Failed Financial Institutions



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Historical Statistics on Banking (http://www2.fdic.gov/hsob/index.asp), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Cost of failure for Washington Mutual Bank is zero.
2. Cost of failure is the FDIC's estimate of the cost to the DIF (Deposit Insurance Fund) at the time of seizure of the failed institution, when available. Otherwise, the cost of failure is based on FDIC estimates from December 31, 2010.

Cost of Failure for Financial Institutions per Dollar of Assets
2009 Failed Financial Institutions



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Historical Statistics on Banking (http://www2.fdic.gov/hsob/index.asp), and Highline Financial Intelligence based on regulatory filings.

Note:
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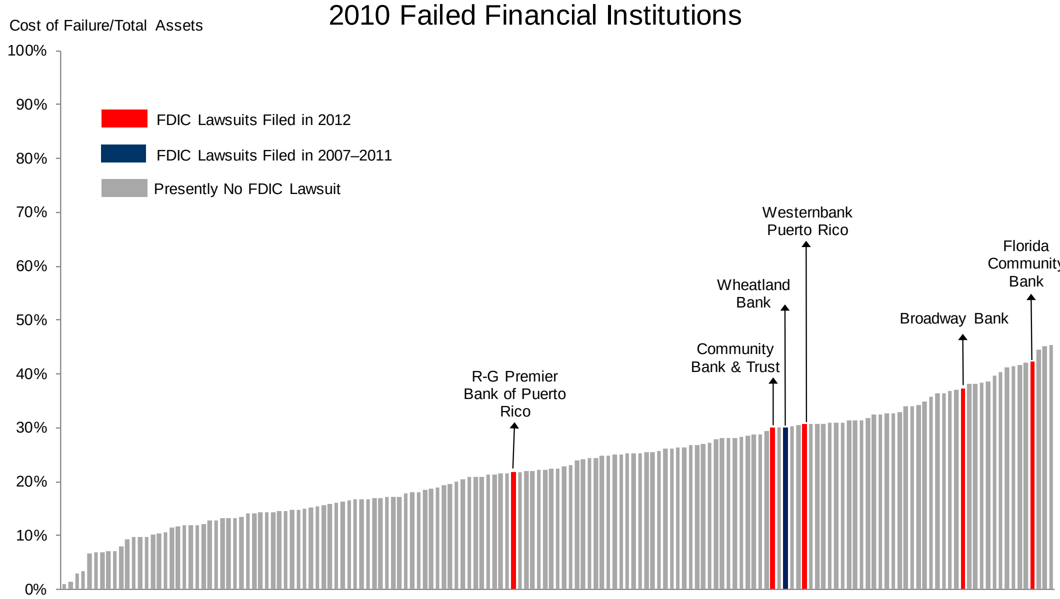
Cost of Failure for Financial Institutions per Dollar of Assets
2010 Failed Financial Institutions



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Historical Statistics on Banking (http://www2.fdic.gov/hsob/index.asp), and Highline Financial Intelligence based on regulatory filings.

Note:
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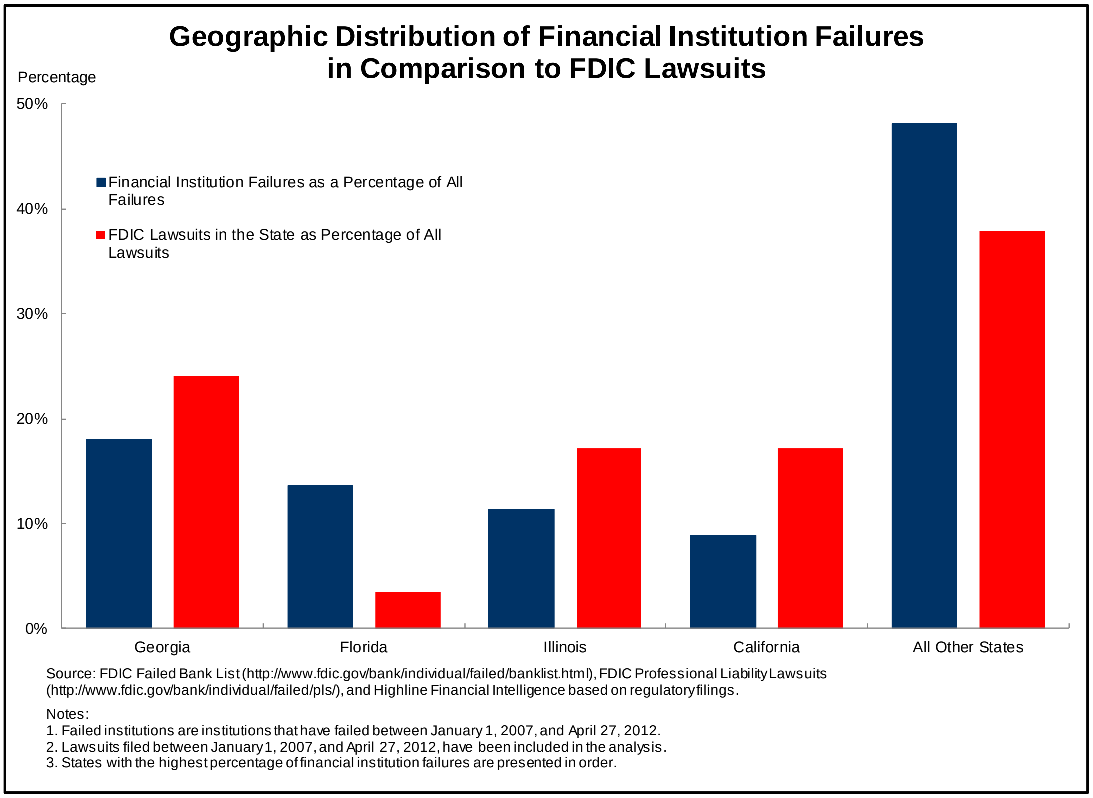
Each federal banking regulator was the primary supervisor for at least one of the institutions targeted by an FDIC lawsuit. Among the 28 institutions targeted in lawsuits, three were savings associations regulated by the former Office of Thrift Supervision, three were nationally chartered commercial banks regulated by the Office of the Comptroller of the Currency, 20 were state-chartered nonmember banks supervised by the FDIC, and two were state-chartered member banks supervised by the Federal Reserve Board.

Geographically, the largest concentration of financial institution failures between 2007 and April 2012 occurred in Georgia, Florida, Illinois and California. The percentage of FDIC lawsuits targeting failed institutions in Georgia, Illinois and California is similarly high and in fact, slightly higher than the percentage of failed institutions in these states. Florida is currently the exception, with only one FDIC lawsuit related to the failure of a Florida institution.



Geographic Distribution of Financial Institution Failures in Comparison to FDIC Lawsuits

Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Failed institutions are institutions that have failed between January 1, 2007, and April 27, 2012.
2. Lawsuits filed between January 1, 2007, and April 27, 2012, have been included in the analysis.
3. States with the highest percentage of financial institution failures are presented in order.

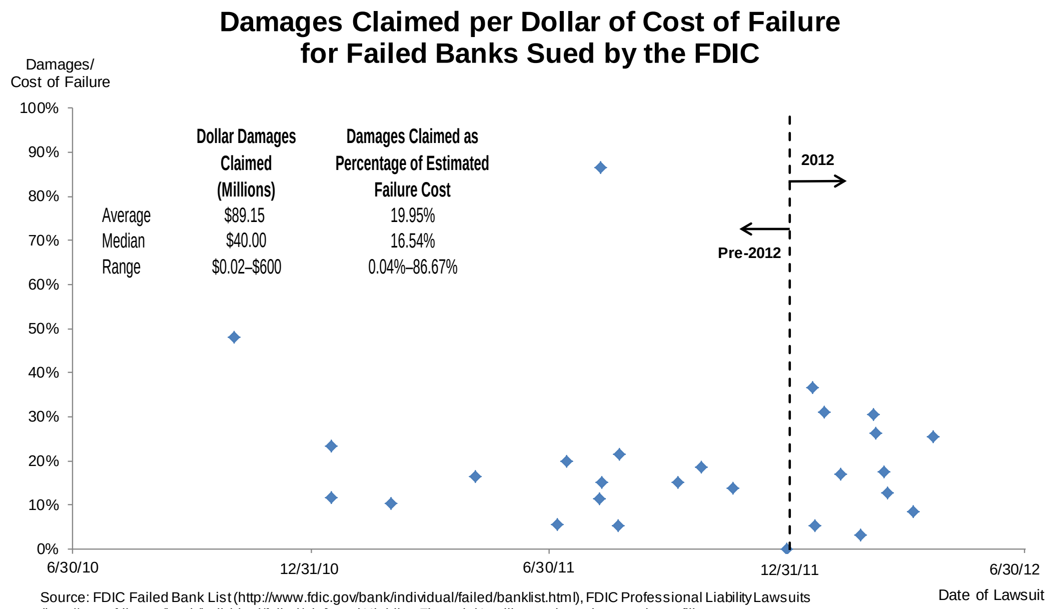
Defendants and Claims

Defendants named in the 29 filed lawsuits included 239 former directors and officers. In nine of these cases, only inside directors and officers were named as defendants. Outside directors were named as defendants in addition to inside directors and officers in the remaining 20 lawsuits. CEOs were named as defendants in 26 cases. Other officers commonly named as defendants included CFOs (five cases), chief loan officers (nine cases), chief credit officers (nine cases), chief operating officers (six cases), and chief banking officers (two cases). In addition, three lawsuits named insurance companies as defendants, and one case identified a law firm as a defendant. Three cases also included spouses of the directors and officers as named defendants. Although we do not address separate suits that may be brought only against other associated parties, such as accountants, appraisers or brokers, these parties are also potentially subject to litigation by the FDIC.

Allegations of negligence, gross negligence and breach of fiduciary duty were made in 26, 26 and 23 of the lawsuits, respectively.

Damages Claimed

In 27 of the 29 complaints, the FDIC explicitly claimed damages amounts ranging from $20,000 to more than $600 million. The average and median damages claims were $89 million and $40 million, respectively. Ignoring outliers, damages claims generally ranged between 5 percent and 37 percent of the FDIC's estimated cost of failure, with a median value of 16.5 percent. No discernible relationship is evident between the date of filing and the damages claimed, although more lawsuits in 2012 than in prior years have claimed damages greater than 25 percent of failure costs

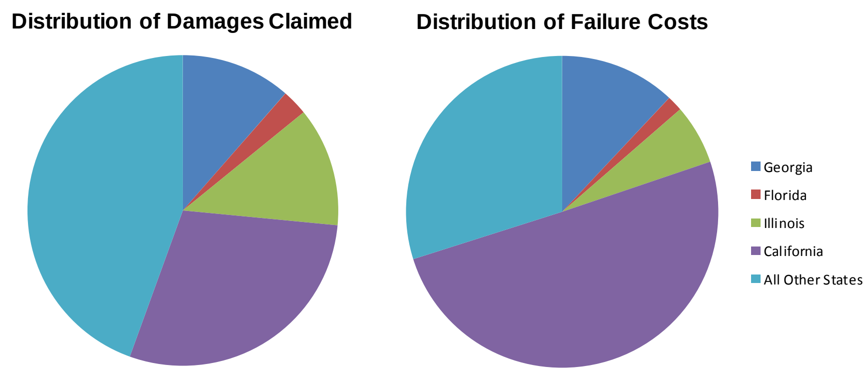


Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Failed institutions are institutions that have failed between January 1, 2007, and April 27, 2012.
2. Lawsuits filed between January 1, 2007, and April 27, 2012, have been included in the analysis.
3. Cost of failure is the FDIC's estimate of the cost to the DIF (Deposit Insurance Fund) at the time of seizure of the failed institution, when available. Otherwise, the cost of failure is based on FDIC estimates from December 31, 2010.
4. Damages claimed are not available in two lawsuits: *FDIC as Receiver of IndyMac Bank, F.S.B v. Van Dellen, et. al.* and *FDIC as Receiver for Washington Mutual Bank v. Killinger, et al.* The complaints filed by the FDIC state that damages will be estimated at trial. These observations are excluded from the chart above.

More than 50 percent of the FDIC's total damages claims were made in lawsuits targeting failures in the four states with the highest concentration of failed financial institutions (Georgia, Florida, Illinois and California). Among the four states, lawsuits related to failed California institutions represented the largest proportion (30 percent) of the damages claims to date. While the largest proportion of claimed damages related to failed institutions in California, the claimed damages were not as large as they might have been had the FDIC used the estimated cost of an institution's failure as the basis for its potential claims.

Geographic Distribution of Damages Claimed and Failure Costs
Failed Banks Sued by the FDIC



Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html), FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), and Highline Financial Intelligence based on regulatory filings.

Notes:
1. Failed institutions are institutions that have failed between January 1, 2007, and April 27, 2012.
2. Lawsuits filed between January 1, 2007, and April 27, 2012, have been included in the analysis.
3. Cost of failure is the FDIC's estimate of the cost to the DIF (Deposit Insurance Fund) at the time of seizure of the failed institution, when available. Otherwise, the cost of failure is based on FDIC estimates from December 31, 2010.
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5. Cost of failure for Washington Mutual Bank is zero.

Losses on CRE and ADC loans were the most common bases for alleged damages. Seventeen of the complaints identified CRE loans as a basis for the damages claim and fifteen identified ADC loans as a basis. Despite the widespread problems in residential lending and residential real estate markets, fewer lawsuits focused on those types of lending.

Future Lawsuits

These findings do not include the many negotiations and mediation discussions the FDIC has undertaken with officers and directors of failed institutions. Statistics for these activities are unavailable. The number of lawsuits filed has yet to approach the numbers authorized by the FDIC, and in recent months, the difference between the number of lawsuits authorized and the number filed has increased. As of April 25, 2012, the FDIC has authorized lawsuits in connection with 58 failed institutions against 493 individuals.

Based on the number of authorized lawsuits that have not yet been filed by the FDIC, and prior experience with the savings and loan (S&L) crisis, one can expect to see more lawsuits targeting directors and officers of large failed institutions with a high estimated cost of failure. Evidence from the S&L crisis that began in the late 1980s would also indicate that more lawsuits and continued negotiation or mediation of potential claims are likely. The Resolution Trust Corporation (RTC) was created in 1989 to resolve the disposition of the assets and the liabilities of failed S&Ls. It closed 747 institutions between 1989 and 1995. In more than 50 percent of the failures, the RTC either pursued civil actions, settled claims prior to filing a lawsuit or tolled the statute of limitations to permit settlement talks or additional investigation. As discussed above, only 6 percent of recently failed banks currently are the subject of FDIC lawsuits, with lawsuits authorized for another 7 percent.

Difference between Filed FDIC Lawsuits and Authorized FDIC Lawsuits

	As of January 18, 2012		As of April 25, 2012	
	Filed	**Authorized**	**Filed**	**Authorized**
Number of Institutions	18	44	28	58
Number of Individuals (D&O)	161	391	239	493
Damages Claimed (Billions)	$1.7	$7.7	$2.4	N.A.

Source: FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), and complaints filed by the FDIC.

Note:
1. The FDIC has not disclosed total damages claimed in the lawsuits authorized as of April 25, 2012.

Settlements

No new resolutions of lawsuits have been announced since our last report. As of April 27, 2012, three of the 29 lawsuits have settled.

- *FDIC as Receiver of Corn Belt Bank and Trust Company v. Stark et al.* settled on May 24, 2011, with settlement details remaining undisclosed.
- *FDIC as Receiver for First National Bank of Nevada v. Dorris and Lamb*, which claimed damages of $193 million, settled on October 13, 2011, with the two officer and director defendants each agreeing to pay $20 million. The defendants assigned their rights to collect from the insurer to the FDIC. The FDIC's success in collecting from the insurer is unknown.
- *FDIC as Receiver for Washington Mutual Bank v. Killinger et al.* agreed to settle in late-2011 with three former executives agreeing to pay $64 million in total. The case was dismissed by the court on April 26, 2012.

About the Authors and Cornerstone Research

Abe Chernin is a senior manager in the San Francisco office of Cornerstone Research; Catherine J. Galley is a senior vice president of Cornerstone Research in the firm's Los Angeles office; Yesim J. Richardson is a vice president in the firm's Boston office; and Joseph T. Schertler is a senior consultant in the firm's Menlo Park office.

For more than twenty-five years, Cornerstone Research and its affiliated testifying experts have provided economic and financial analysis of complex issues arising in commercial litigation and regulatory proceedings. During this time, we have worked on behalf of defendants in lawsuits brought by the RTC and FDIC. Cornerstone Research has more than four hundred staff and offices in Boston, Los Angeles, Menlo Park, New York, San Francisco and Washington.

www.cornerstone.com

Appendix 1

Summary of FDIC Professional Liability Lawsuits

January 1, 2007–April 27, 2012

	2007–2009	2010	2011	2012 (1/1–4/27)	Total
Number of FDIC Lawsuits	0	2	16	11	29
Number of Directors and Officers Named as Defendants	0	15	127	97	239
Damages Claimed (if Stated) (in Millions)	$0.0	$20.0	$1,294.9	$1,092.1	$2,407.1
Settled Cases	N.A.	0	3	0	3
Failed Institutions	168	157	92	22	439

Source: FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/), complaints filed by the FDIC, PACER, and Highline Financial Intelligence based on regulatory filings.

Note:
1. Financial institutions include commercial banks, savings banks, and savings and loans (thrifts).
2. Lawsuits filed between January 1, 2007, and April 27, 2012, have been included in the analysis.
3. Failed institutions are institutions that failed between January 1, 2007, and April 27, 2012.
4. Current status of lawsuits is tracked using PACER. Information was found on PACER for two settlements, whereas information for the most recent settlement was based on news articles in the public domain.

Appendix 2

FDIC Professional Liability Lawsuits
Dollar Damages and Damages Bases Alleged against Defendants

	Dollar Damages Claimed [1] (Millions)	Damages Claimed as Percentage of Estimated Failure Cost [2]
Average	$89.15	19.95%
Median	$40.00	16.54%
Range	$0.02–$600	0.04%–86.67%

	Percentage of Lawsuits		
Damages Bases	**All**	**Filed 2007–2011**	**Filed 2012**
Loss on Commercial Real Estate Loans	58.62%	55.56%	63.64%
Loss on Acquisition Development Construction Loans	51.72%	38.89%	72.73%
Loss on Commercial Loans	20.69%	27.78%	9.09%
Loss on Residential Loans	20.69%	22.22%	18.18%
Loss on Insider Loans	6.90%	11.11%	0.00%
Loss on Lines of Credit	3.45%	5.56%	0.00%
Loss on Held-for-Investment Residential Loan Portfolios	3.45%	5.56%	0.00%
Loss on Business Loans	3.45%	5.56%	0.00%
Loss on Alt-A Loans	3.45%	5.56%	0.00%
Loss on Lot Loans	3.45%	5.56%	0.00%
Loss on Asset-Based Loans	3.45%	0.00%	9.09%
Loss on Personal Loans	3.45%	0.00%	9.09%
Loss in Connection with Imprudent Dividend Payments	3.45%	5.56%	0.00%
Loss on OREO Properties	3.45%	0.00%	9.09%

Source: Complaints filed by the FDIC, FDIC Historical Statistics on Banking (http://www2.fdic.gov/hsob/index.asp), and FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html).

Notes:
1. A damages claim was stated in all but two of the FDIC lawsuits.
2. Cost of failure is the FDIC's estimate of the cost to the DIF (Deposit Insurance Fund) at the time of seizure of the failed institution, when available. Otherwise, the cost of failure is based on FDIC estimates from December 31, 2010.
3. Lawsuits filed between January 1, 2007, and April 27, 2012, have been included in the analysis.

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