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

April 2013

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CORNERSTONE RESEARCH

Report Summary

- At least 12 FDIC D&O lawsuits have been filed in 2013, 10 in the first quarter and at least two in the first three weeks of April. The pace of filings in the first quarter of 2013 slowed slightly in comparison with the 12 filed lawsuits in the fourth quarter of 2012, but is higher than any previous quarter in 2010, 2011, or 2012. If the filing of new lawsuits continues in 2013 at the pace observed through the third week of April, 39 lawsuits will be filed this year—more than any year since the financial crisis began.

- FDIC seizures of financial institutions continued to decline so far in 2013 compared with 2012. Eight institutions have been seized as of April 22, 2013. Since 2007, 476 financial institutions have failed.

- Institutions that are subject to D&O litigation have historically been larger (in terms of assets) and have had higher estimated costs of failure than the average failed financial institution. While this was not true in the second half of 2012, the FDIC's recently filed D&O lawsuits have again, on average, targeted larger failed institutions.

- Chief executive officers continue to be the most commonly named defendants. They have been named in 88 percent of all filed complaints and 10 of the 12 lawsuits in 2013. Chief financial officers, chief credit officers, chief loan officers, chief operating officers, and chief banking officers are other commonly named defendants. Outside directors have been named, frequently along with inside directors, in 75 percent of all filed complaints and nine of the 12 lawsuits filed in 2013.

- The FDIC has recently begun to publish settlement agreements related to its professional liability cases. Based on the settlement agreements we have reviewed, the FDIC has obtained aggregate settlements of $601 million—$115 million attributable to filed D&O lawsuits, $216 million attributable to claims involving D&Os that did not result in a filed complaint, and $270 million attributable to claims against professional firms and non-D&O individuals associated with failed financial institutions.

- Since the December 7, 2012, trial verdict of three former officers of IndyMac's Homebuilder Division resulting in a $169 million award, the parties have filed post-trial briefs on the applicability of pre- and post-judgment interest. The court has ordered that both are appropriate. A mediation to address remaining issues is scheduled for May. The D&O insurance carrier will participate in the mediation.

This is the fifth in a series of reports that analyzes the characteristics of professional liability lawsuits filed by the Federal Deposit Insurance Corporation (FDIC) against directors and officers (D&O) of failed financial institutions. The FDIC may also file lawsuits against other related parties, such as accounting firms, law firms, appraisal firms, or mortgage brokers, but we generally do not address such lawsuits here.

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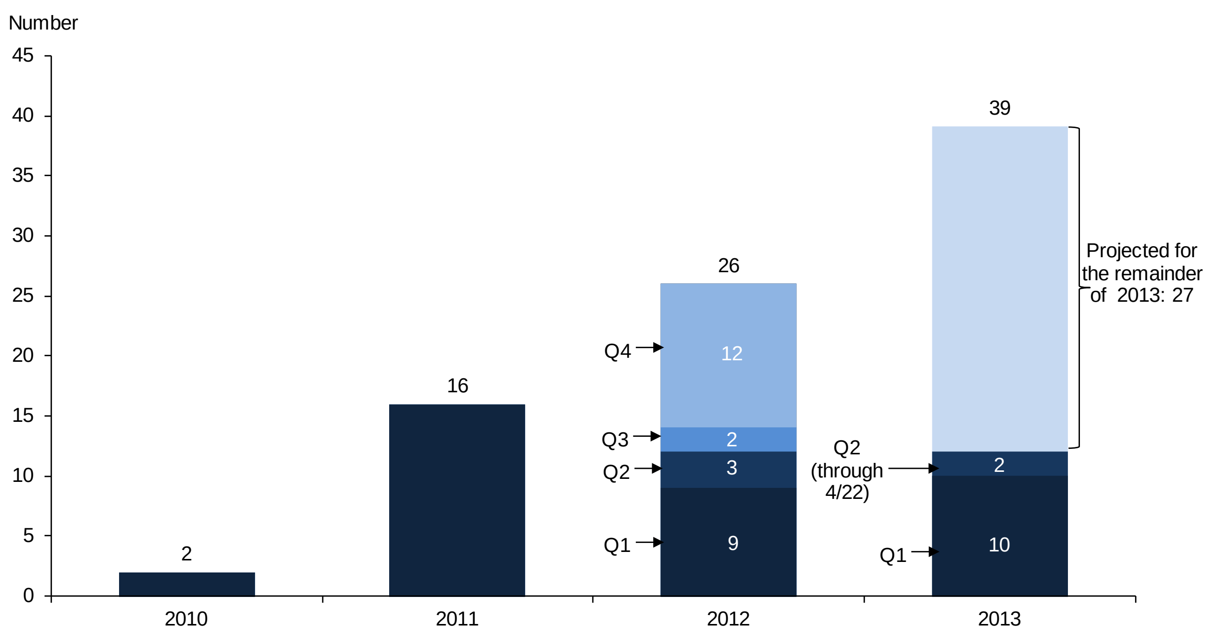
Overview of Litigation Activity

So far in 2013, FDIC litigation against directors and officers of failed financial institutions remained at levels comparable to the heightened level of activity observed in the fourth quarter of 2012. From the beginning of the year through April 22, the FDIC filed at least 12 new lawsuits against directors and officers of failed institutions, the same number it filed in the fourth quarter of 2012. If the recent pace of new filings persists for the balance of 2013, we expect 39 lawsuits will be filed by the end of the year. This reflects an increased level of filing activity compared with 26 lawsuits in 2012, 16 in 2011, and two in 2010. In total, 56 lawsuits have been filed since 2010 against the directors and officers of 55 institutions.

Number of FDIC Lawsuits against Directors and Officers of Failed Financial Institutions
2010–2013



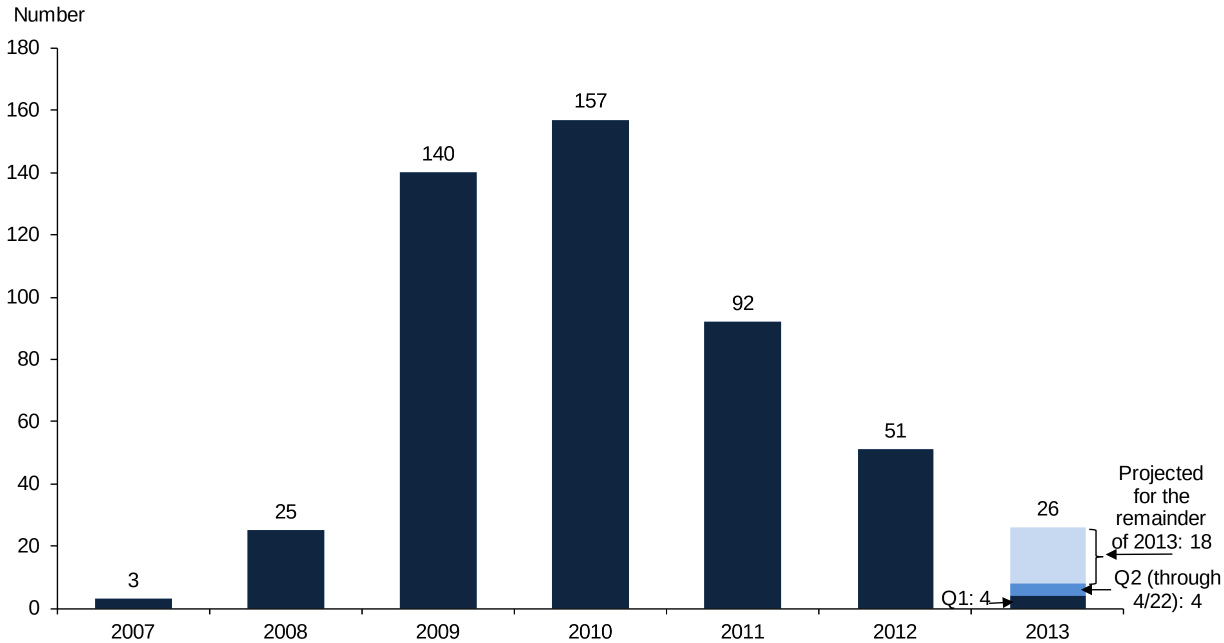
Source: FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/)

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 22, 2013. Projected numbers for 2013 assume that the FDIC will file lawsuits at the same rate observed between January 1, 2013, and April 22, 2013.

Financial Institution Failures

Seizures of banks and thrifts by the FDIC have continued to decline in 2013 compared with 2012. Only eight institutions failed between January 1, 2013, and April 22, 2013. If this rate of failure continues during the remainder of the year, 26 institutions will fail in 2013, an amount nearly identical to the number of failed institutions in 2008 at the onset of the financial crisis. Since the beginning of 2007, 476 financial institutions have failed.

Number of Failed Financial Institutions
2007–2013



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. For 2013, data for failed institutions are through April 22, 2013. Projected numbers for 2013 assume institutions will fail at the same rate observed between January 1, 2013, and April 22, 2013.

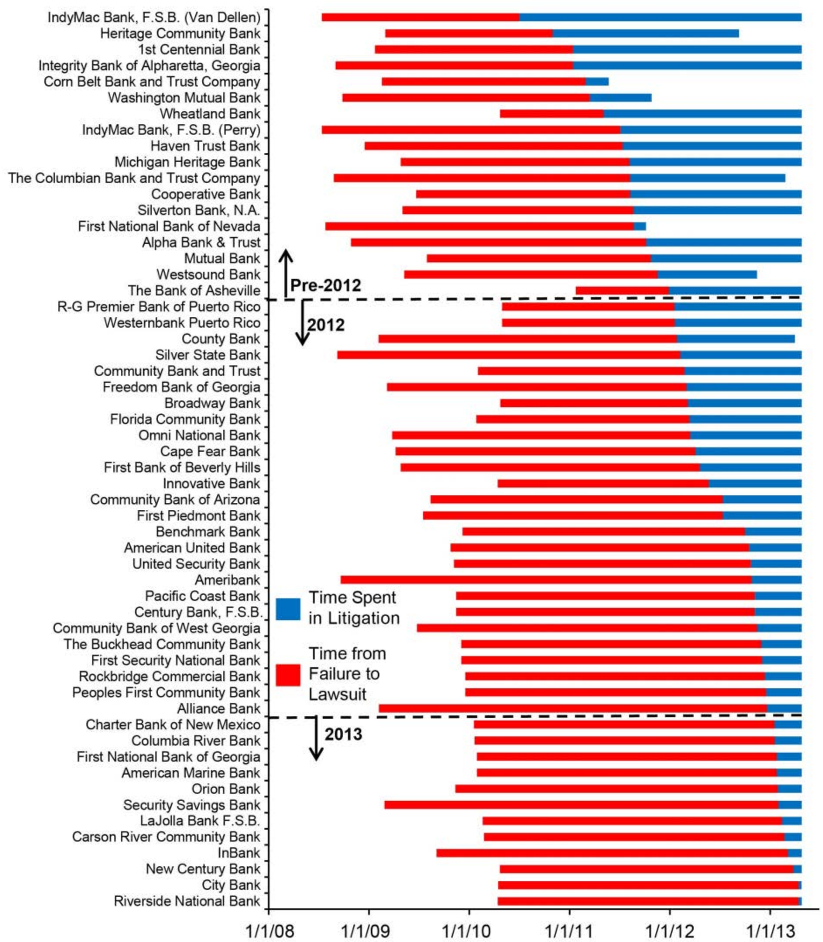
Financial institution failures were most common between the third quarter of 2009 and the third quarter of 2010. Between 41 and 50 institutions failed in each of those quarters. Given the three-year statute of limitations for tort lawsuits and the likely existence of tolling agreements allowing the FDIC additional time to determine if it will file a lawsuit, this year is likely to be a peak period for new filings.

Characteristics of Director and Officer Lawsuits

Timing of Lawsuits

Since the middle of 2012, the FDIC has consistently waited to file lawsuits until approximately three years after the failure of a financial institution. Most lawsuits have been filed just prior to the expiration of the three-year statute of limitations for tort lawsuits. During this period, the only instance of a lawsuit being filed substantially earlier was a case against the directors and officers of Innovative Bank on May 23, 2012, approximately two years and one month after Innovative Bank's failure. In three instances so far in 2013, the FDIC took longer than three years to file a lawsuit, presumably due to the existence of tolling agreements.

FDIC Lawsuits
Time from Financial Institution's Failure to Lawsuit and Time Spent in Litigation



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/)

Note: Financial institutions are ordered based on the date of lawsuit. Lawsuits are deemed completed when a final judgment has been ordered.

Size of Institutions Subject to Litigation

To date, 12 percent of financial institutions that have failed since 2007 have been the subject of FDIC D&O lawsuits. These lawsuits generally have targeted larger failed institutions and those with a higher estimated cost of failure. Of the 55 institutions that are the subject of FDIC lawsuits, 41 had total assets greater than $220 million, the median total asset size of failed institutions since January 2007. In the first quarter of 2013, larger and more costly failures were again more often the subject of FDIC lawsuits, reversing a pattern observed in the second half of 2012, when the lawsuits targeted smaller and less costly failures. The institutions targeted in the third and fourth quarters of 2012 had median total assets of $136 million and $187 million, respectively. In contrast, the institutions targeted in the first quarter of 2013 and the two institutions targeted so far in April had median total assets of $644 million and $2.3 billion, respectively.

The 55 institutions that are the subjects of D&O lawsuits had a median estimated cost to the FDIC of $158 million at the time of seizure. The institutions that were subject to the 10 FDIC lawsuits filed in the first quarter of 2013 had a median cost of failure of $149 million. The two institutions that have been the subject of lawsuits so far in April had a median cost of failure of $408 million. This compares with the median estimated cost of $52 million for all failed financial institutions.

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			
1/1/07–12/31/11	17	$735.1	$158.1
Q1 2012	9	$1,181.7	$354.5
Q2 2012	3	$492.4	$131.0
Q3 2012	2	$136.3	$27.3
Q4 2012	12	$187.1	$74.5
Q1 2013	10	$643.9	$148.9
Q2 2013	2	$2,254.0	$407.6
All Institutions (1/1/07–4/22/13)	55	$755.9	$158.1
Failed Institutions (1/1/07–4/22/13)	476	$220.3	$52.2
Active Financial Institutions (as of 12/31/12)	7,151	$166.0	N.A.

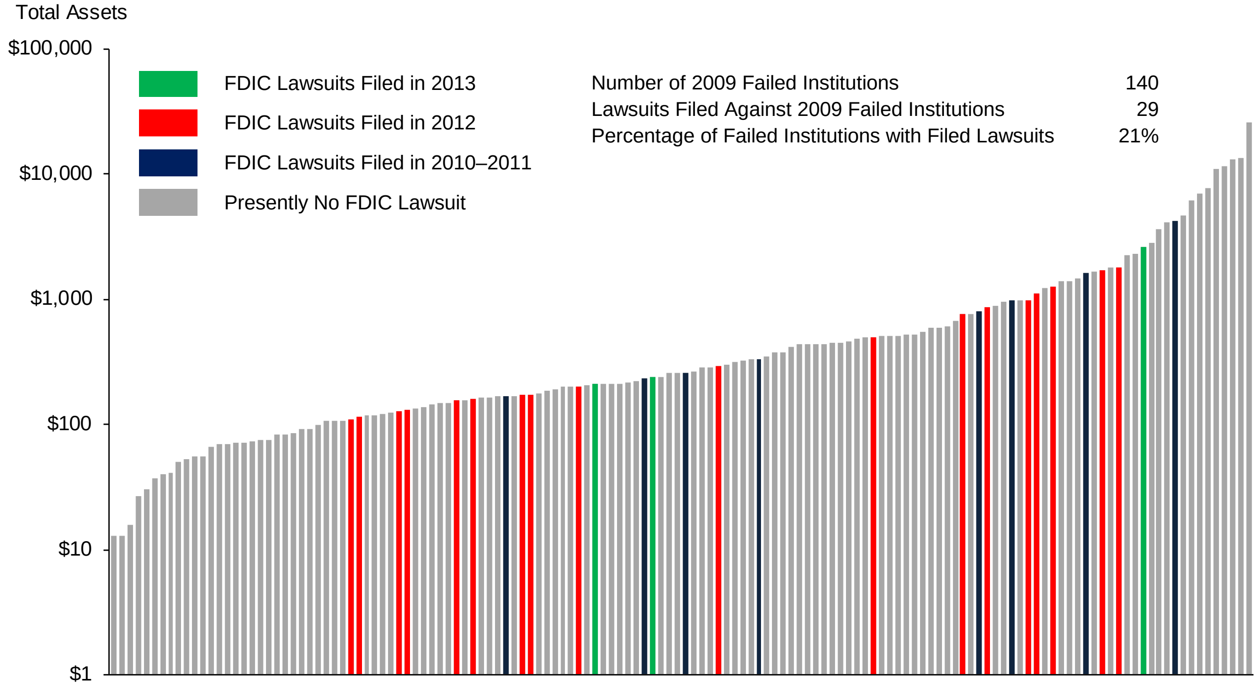
Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html); FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/); Highline Financial Intelligence based on regulatory filings

Note:
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 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.

As noted above, the FDIC typically has a three-year window to file lawsuits after the failure of a financial institution. We do not have data on the number of existing tolling agreements that allow this window to be extended. We therefore cannot project how many directors and officers of financial institutions that failed in 2009 may possibly be sued going forward. The current data indicate that 21 percent of the 2009 failures have already been subject to FDIC D&O lawsuits. The majority of these lawsuits were filed in 2012, with three additional lawsuits filed so far in 2013. Notably, the FDIC has not to date filed lawsuits against the directors and officers of the largest institutions that failed in 2009.

Total Assets of Financial Institutions That Failed in 2009

Dollars in Millions

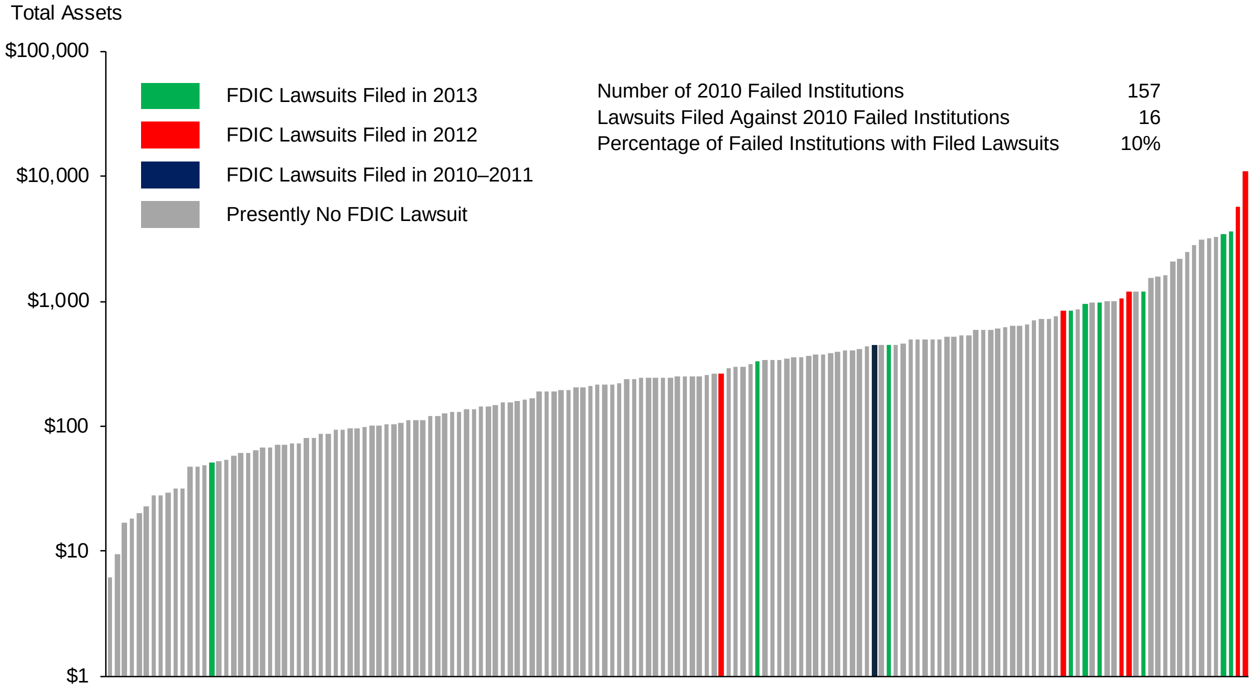


Source: FDIC Failed Bank List (http://www.fdic.gov/bank/individual/failed/banklist.html); FDIC Historical Statistics on Banking (http://www2.fdic.gov/hsob/index.asp); Highline Financial Intelligence based on regulatory filings

Note: Total Assets are presented on a logarithmic scale.

Of the financial institution failures in 2010, directors and officers of 10 percent have to date been subject to lawsuits. Nine such lawsuits were filed in 2013 and seven in prior years. All but one of these lawsuits targeted institutions with total assets of more than $100 million, including the four largest failures in 2010.

Total Assets of Financial Institutions That Failed in 2010
Dollars in Millions



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); Highline Financial Intelligence based on regulatory filings

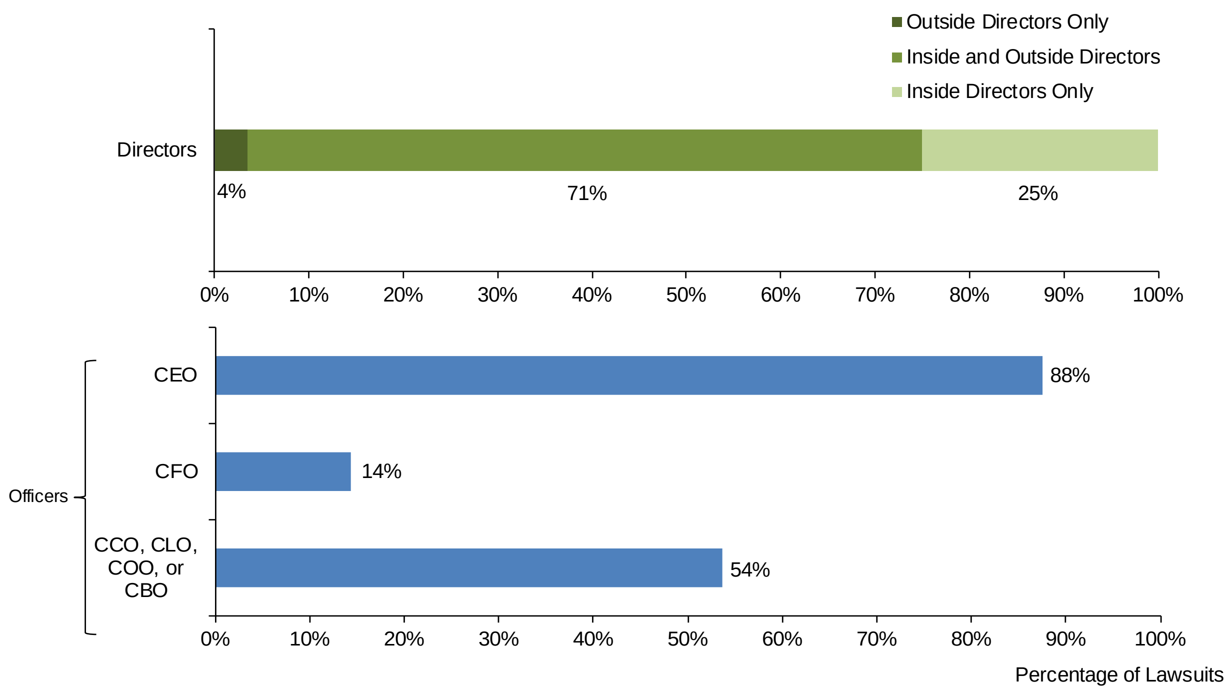
Note: Total Assets are presented on a logarithmic scale.

Defendants and Claims

Defendants named in the 56 filed lawsuits included 417 former directors and officers. Inside and outside directors were routinely named as defendants. Outside directors were exclusively named as defendants in rare instances (two out of 56 cases). Somewhat more common were cases in which only inside directors were named (14 out of 56 cases). CEOs were named as defendants in 88 percent of cases, including 10 of the 12 lawsuits filed so far in 2013. Other officers commonly named as defendants included:

- Chief financial officers (14 percent of cases—one additional case in 2013)
- Chief credit officers (34 percent of cases—four additional cases in 2013)
- Chief loan officers (18 percent of cases—no change since end of 2012)
- Chief operating officers (18 percent of cases—one additional case in 2013)
- Chief banking officers (4 percent of cases—no change since end of 2012)

Percentage of FDIC Lawsuits in which Certain Parties Were Named as Defendants



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

Note: CCO refers to Chief Credit Officer, CLO refers to Chief Loan Officer, COO refers to Chief Operating Officer, and CBO refers to Chief Banking Officer.

In addition, the number of D&O lawsuits that also named insurance companies as defendants remained at three, and only one case also identified a law firm as a defendant. However, according to the recently published FDIC settlements data, there have been other claims and separate lawsuits brought against insurance companies and law firms. The number of cases that included spouses of the directors and officers as defendants remained at three.

All 12 lawsuits filed so far in 2013 included allegations of gross negligence and breach of fiduciary duty. Nine of the 12 lawsuits included allegations of negligence. Overall, of the 56 lawsuits filed since 2010, allegations of gross negligence, negligence, and breach of fiduciary duty were made in 53, 50, and 42 lawsuits, respectively.

Resolutions and Settlements

In response to criticism that it has not been forthcoming with information on its settlement activity, the FDIC has begun to publish settlement agreements related to its professional liability claims. The published settlements cover nine agreements related to five of the D&O lawsuits that are the primary topic of this report, 33 settlements of claims involving directors and officers of other failed institutions that did not result in filed complaints, and 310 settlements with professional service firms and non-D&O individuals (such as appraisal firms and appraisers).

Based on the settlement agreements published by the FDIC, one of the D&O lawsuits has settled so far in 2013. Our analysis of the agreements and other legal documents filed in court indicates that seven of the filed lawsuits have settled so far. We are aware of no new trials since the IndyMac trial of November through December 2012. Post-trial briefs and additional arguments related to damages continue in the IndyMac case, as we discuss in more detail below.

Details of Resolutions of FDIC Lawsuits against Directors and Officers

Settlements

Name of Institution	State	Lawsuit Date	Settlement Date	FDIC Estimated Cost of Failure [1] (Millions)	Claimed Damages in Complaint (Millions)	Settlement Amount (Millions)	Number of D&Os Sued
The Columbian Bank and Trust Company	KS	8/9/11	2/15/13	$60	$52	$5.2 [2]	6
Westsound Bank	WA	11/18/11	11/15/12	$108	$15	$1.7	11
County Bank	CA	1/27/12	11/13/12	$135	$42	$0.5 [3]	5
Heritage Community Bank	IL	11/1/10	9/10/12	$42	$20	$3.2	11
Washington Mutual Bank	NV	3/16/11	12/13/11	$0	N.A.	$64.0 [4]	3
First National Bank of Nevada	NV	8/23/11	10/13/11	$862	$193	$40.0 [5]	2
Corn Belt Bank and Trust Company	IL	3/1/11	5/10/11	$100	$10	$0.7	4

Trial

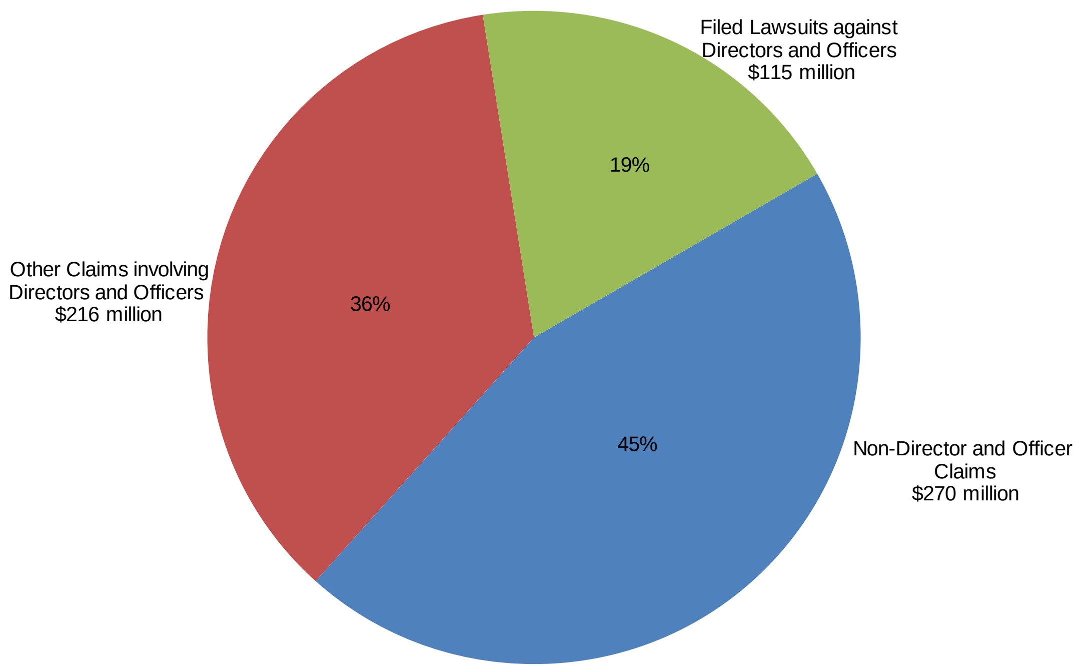
Name of Institution	State	Lawsuit Date	Settlement Date	FDIC Estimated Cost of Failure [1] (Millions)	Claimed Damages in Complaint (Millions)	Settlement Amount (Millions)	Number of D&Os Sued
IndyMac Bank, F.S.B. (Van Dellen)	CA	7/2/10	12/7/12	$10,700	N.A.	$169	4

Source: FDIC Failed Banks List (http://www.fdic.gov/bank/individual/failed/banklist.html); FDIC Professional Liability Lawsuits (http://www.fdic.gov/bank/individual/failed/pls/); complaints filed by the FDIC; PACER; public press

Note:
1. Cost of failure is the cost estimated at the time of failure.
2. Three of the six defendants settled with the FDIC in 2011 and 2012 for a combined amount of $210,000. The remaining three defendants settled with the FDIC on February 15, 2013, for $5,000,000.
3. The directors and officers settled for $500,000 by assigning their rights to the FDIC for their claims against the bank's bankrupt holding company and its insurance carrier. The settlement agreement also allowed for a final judgment that the FDIC could seek to recover from the insurance carrier. On April 1, 2013, the court awarded to the FDIC a final judgment of $48.5 million.
4. Comprised of $39.575 million cash obtained from the D&O insurance policies, cash payments from the defendants of $425,000, and their agreement to pay the FDIC an additional cash amount based upon the amounts defendants actually receive, after tax, from certain of their claims pending in the Washington Mutual Inc. Chapter 11 proceedings (with a $24.7 million pre-tax face value).
5. In response to a joint motion from the FDIC and the defendants, on October 13, 2011, the court entered a judgment in favor of the FDIC in the amount of $40,000,000. The amount collected from the bank's two insurance carriers is unknown.

The FDIC has stated that it will continue to publish settlement agreements on an ongoing basis, but has not indicated whether it has released all data on past settlements. Our analysis therefore may not cover all FDIC settlement activity. As of April 4, 2013, approximately 352 settlement agreements were posted on the FDIC's website. These settlements relate to 63 failed institutions across 25 states and are dated as early as October 2008 and as late as March 2013. The aggregate settlement amount specified in the agreements, including two not contained in the FDIC's list that we independently identified, is $601 million. Settlements with defendants in D&O lawsuits were $115 million, while $216 million stem from settlements of claims involving directors and officers (as well as additional parties in some cases) that did not result in a lawsuit. The remaining $270 million are from non-D&O settlements. The majority of this last category of settlements involves claims against parties such as mortgage brokers, realty firms, appraisal firms, title insurance firms, and individuals involved in loan origination.

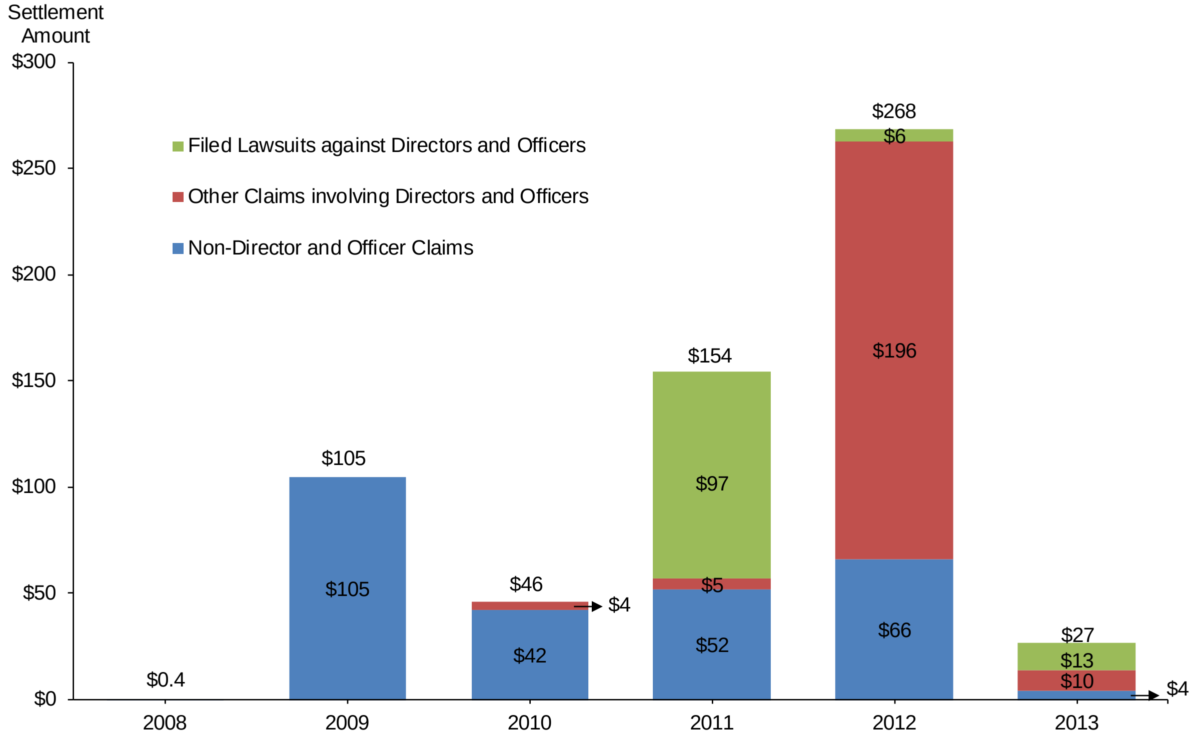
Source and Amount of FDIC Settlements of Professional Liability Claims
January 2008–April 2013



Source: FDIC Professional Liability Settlement Agreements (http://www.fdic.gov/about/freedom/plsa/index.html); complaints filed by the FDIC; PACER; public press

The total settlement amount of $268 million from agreements in 2012 was larger than in prior years. The majority of the increase over prior years was attributable to two settlements: a settlement for $125 million of claims against the directors and officers of BankUnited FSB and a settlement for $32.1 million of claims against the directors and officers of Downey Savings & Loan.

Source and Amount of FDIC Settlements of Professional Liability Claims
January 2008–April 2013
Dollars in Millions



Source: FDIC Professional Liability Settlement Agreements (http://www.fdic.gov/about/freedom/plsa/index.html); complaints filed by the FDIC; PACER; public press

A review of the settlement agreements shows that, of the 44 agreements involving directors and officers (regardless of whether a lawsuit was filed), as many as 17 agreements, or 39 percent, required out-of-pocket payments by the directors and officers. Directors and officers agreed to pay $8 million out of pocket in these cases. These payments were frequently in addition to amounts to be paid by insurance carriers. While many of the settlement agreements with directors and officers indicate that insurance carriers were a party to the settlement, some do not. Moreover, a number of agreements indicate that the amount the FDIC may recover will depend on the outcome of disputes related to insurance coverage.

Update on the Jury Trial Verdict against Former Officers of IndyMac Bank

On December 7, 2012, a jury in federal court in Los Angeles found three former officers of IndyMac Bank liable for $169 million in damages in connection with 23 loans. This was the first D&O lawsuit filed by the FDIC after the 2008 financial crisis and the first case to go to trial. No final judgment has yet been entered in the case. A three-day mediation between the FDIC, the defendants, and the insurance carrier providing D&O coverage is scheduled to start on May 8, 2013. The parties will attempt to resolve outstanding issues, including the extent of available insurance coverage.

In the months since the trial, the FDIC and the defendants briefed the court on the appropriateness of assessing pre- and post-judgment interest. The FDIC claimed that both were required to compensate it for the losses caused by the plaintiffs. It argued that prejudgment interest was within the discretion of the court and should be applied from the time borrowers stopped making contractually required payments on the loans at issue through the date of the judgment. The FDIC provided an expert declaration opining prejudgment interest amounted to $45.4 million to $68.6 million, with the low end based on a compound one-year Treasury rate and the high end based on a simple 7 percent California statutory rate. The Treasury rates used by the FDIC were historical rates of 2.19 to 4.95 percent from 2007 and 2008.

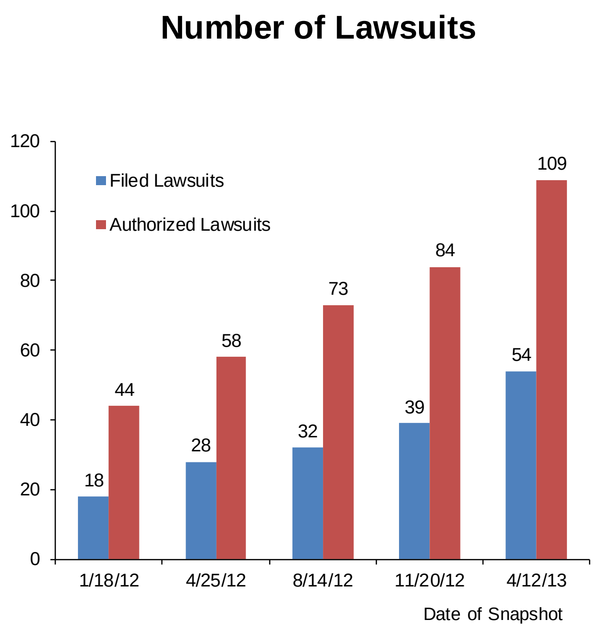
The defendants argued in their response that prejudgment interest was not warranted, in part because the FDIC had already been adequately compensated by the $169 million verdict, which made no adjustment to damages for any portion of losses that might be attributable to the financial crisis and ensuing recession. The defendants also argued that any prejudgment interest should be based on the prevailing Treasury rate at the time of the jury verdict in December 2012, which was approximately 0.18 percent.

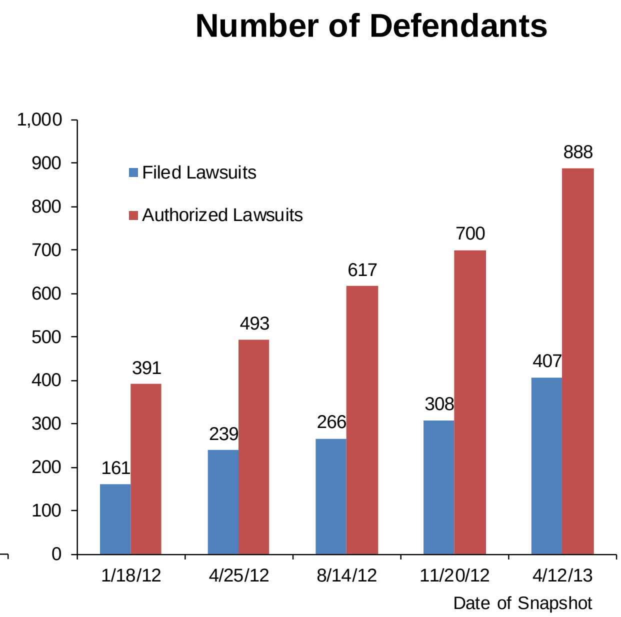
The court ruled in March that the FDIC was entitled to prejudgment interest based on the short-term, risk-free rate in order to compensate the FDIC for “the loss of use of its funds.” Moreover, prejudgment interest is to be calculated starting at the time of the loan or collateral sale dates, rather than at the time the borrowers stopped making payments, as argued by the FDIC. The court also ruled that post-judgment interest was appropriate. The ruling did not specify amounts for either; the exact calculations presumably will be addressed at mediation.

Future Director and Officer Lawsuits

The number of lawsuits authorized has continued to exceed the number filed by the FDIC. As of April 12, 2013, the FDIC had authorized lawsuits against 888 individuals in connection with 109 failed institutions. At that time, 407 individuals had been sued in connection with 54 filed lawsuits. The FDIC's recently released settlement agreements suggest that some settlements occurred after complaints had been authorized. Thus, as many as 481 former directors and officers either negotiated settlements with the FDIC before the authorized lawsuit was filed or are still awaiting a decision on whether the FDIC will file a lawsuit against them. The difference between the number of lawsuits authorized and the number filed increased throughout 2012. That trend has continued in 2013, with the difference between authorized and filed lawsuits climbing to 55 as of April 12, 2013, from 45 as of November 20, 2012. We continue to believe that this backlog of authorized lawsuits, the FDIC's recent success in the IndyMac trial, and the approaching end of the statute of limitations for making a claim against the numerous institutions that failed in 2010 suggest that substantially more FDIC cases may be filed in upcoming months.

Difference between Filed FDIC D&O Lawsuits and Authorized FDIC D&O Lawsuits





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

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For more than twenty-five years, Cornerstone Research staff and 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 FDIC and Resolution Trust Corporation. Cornerstone Research has more than four hundred fifty staff and offices in Boston, Chicago, Los Angeles, Menlo Park, New York, San Francisco, and Washington.

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