FDIC Program for Investigating Bank Failures

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Today's Discussion

- **The FDIC and Failed Banks**
- Professional Liability Program
- Dodd-Frank Act
- Appraisal Work for the FDIC

FDIC Role To Maintain Stability and Confidence in U.S. Banking System

- Corporate Capacity
  - Primary regulator for 4,587 state non-member banks and thrifts
  - Provides deposit insurance for 7,298 banks and thrifts
- Receivership Capacity
  - Acts as receiver for failed banks and thrifts to liquidate assets and pay claims

FDIC as Receiver

- Makes insured deposits available "as soon as possible"
- Resolution Methods – P&A, Payout
- Steps Into Shoes of Failed Institution
  - Acquires "all rights, titles, powers and privileges" of failed institution – 12 U.S.C. § 1821(d)(2)

FDIC - Special Powers as Receiver

- Determine claims
- Right to remove and stay litigation
- Courts may not enjoin or restrain FDIC Receiver
- Administrative subpoena authority

Current Crisis in Perspective: Bank and Thrift Failures, 2007 – 2012

Year	Number of Institutions
2007	3
2008	25
2009	140
2010	157
2011	92
2012 (through May)	24

Current Crisis in Perspective: Bank and Thrift Failures, 1982 – 2012

(Excludes Years With Fewer Than 10 Failures)

Years	Number of Failed Institutions	Assets	Assets - Inflation Adjusted
1982 - 1994	2,341	$657.1 B	$1.16 T
Jul. 2004 – Jan. 2007	0	0	0
2008 – May 31, 2012	438	$675.1 B	$711.3 B

Bank and Thrift Failures, 2007 – 2012, by State

State	Number of Failures	Assets
Georgia	79	$34.1 B
Florida	61	$37.6 B
Illinois	50	$32.9 B
California	39	$103.6 B

*As of May 31, 2012

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Professional Liability Program

- Purposes of Professional Liability Program
  - Maximize asset recovery for receiverships
  - Promote good corporate governance and discipline
  - Maintain public trust, ensure accountability
- Investigate causes of every failure
- Pursue meritorious and cost-effective claims against those responsible for losses to the failed institution

Litigation Authority

- FDIC has litigation authority for its civil actions. 12 U.S.C. § 1819(a)

- DOJ has responsibility for criminal matters

Legal Theories for PL Claims

- Tort claims for breach of fiduciary duty and/or negligence against directors and officers

- Malpractice claims against accountants, attorneys, appraisers, brokers, or other professionals

- Breach of contract claims
  - Fidelity Bonds
  - Mortgage Fraud – CPLs, Closing Instructions, Indemnification

- RMBS claims – State Blue Sky Laws, 1933 Securities Act

Residential MMF Cases

- Liability typically is very clear
- Common defendants are loan originators (mortgage bankers/brokers), closing agents/attorneys, and appraisers
- 167 lawsuits pending and $88.9 million recovered as of May 31, 2012

Safeguards to Ensure Meritorious and Cost-Effective Claims

- Case Development – Investigation and Review
- Ongoing Case Reviews by Management
- Authority To Sue – Board/Delegated Approval
- Settlements – Joint Legal & DRR Approval

Cost-Effectiveness: Most Frequent Recovery Sources

- Available Liability Insurance
- CPLs (MMF only)
- Personal Assets

Appraiser Malpractice Claims

- Appraisers Must Comply with Contractual, Professional (including USPAP), and Ethical Duties
- The FDIC has filed claims against appraisers in the current crisis, particularly in MMF cases.

Appraisal Issues in Recent Bank Failures

- Failing to follow USPAP standards
- Inappropriate comparables / unsupported adjustments
- Failing to report recent sales of appraised property
- Inadequate research
- Failing to perform a site visit when it is required
- Tying compensation/employment to appraisal results

Recent FDIC Complaints Against Appraisers

- WaMu (Henderson, NV) failed Sept. 25, 2008
- The FDIC filed two lawsuits against CoreLogic Valuation Services, LLC, and LSI Appraisal, LLC, in federal court in Los Angeles
  - CoreLogic: $113.5 million in damages related to 195 appraisals
  - LSI: $153 million in damages related to 218 appraisals
- The FDIC's Allegations:
  - Beached national appraisal contracts with WaMu
  - Delivered grossly negligent appraisals with numerous USPAP violations
  - Failed to provide contracted for outside appraisal management services

Definition of “Gross Negligence”

Gross negligence “means negligence that is especially bad” but “that is less than recklessness.”

Restatement (Third) of Torts: Physical and Emotional Harm, § 2 Comment a (2010)

Recent FDIC Complaints Against Appraisers

- Brickwell Community Bank (Brickwell, MN) failed Sept. 11, 2009
- The FDIC filed suit against an individual appraiser and his commercial appraisal firm
  - $946,000 in damages for CRE appraisal
  - Appraisal included 51,000 sq. ft. parking area borrower did not own; borrower owned only 17,455 sq. ft.
  - Appraiser used out-of-area comparables.

Recent FDIC Complaints Against Appraisers

- Michigan Heritage Bank (Farmington Hills, MI) failed April 24, 2009
- The FDIC filed suit against two appraisers
  - FDIC lawsuit claims $1.62 million in damages
  - Appraisal of RE development was based on improvements that did not exist
  - Appraiser falsely claimed she personally made site visit
  - Appraiser instead relied on borrower's unsubstantiated representations that improvements existed.

FDIC Residential MMF Cases

- The FDIC has filed numerous MMF lawsuits against appraisers arising out of the failures of IndyMac, Downey, WaMu, BankUnited, AmTrust, and many other failed institutions.
- Common scenarios in MMF actions
  - Cash-out refinances
  - Flipping transactions
- Typical appraiser issues in MMF actions
  - Incorrect / misrepresented facts supporting appraised value
  - Improper comparables
  - Failure to adjust for negative property attributes

Recent MMF Appraiser Complaint

- AmTrust Bank (Cleveland, OH) failed Dec. 4, 2009
- The FDIC filed suit against an individual appraiser and his appraisal firm
  - $390,000 in damages for residential RE appraisal
  - Appraiser used improper comparables that were not open market transactions.
  - Appraiser failed to discuss property’s listing history.

Statutes of Limitations

- FIRREA re-starts the limitations period to permit the FDIC to file claims as long as they are viable at failure
  - Torts – 3 years from failure
  - Contracts – 6 years from failure

- State statute applies if longer

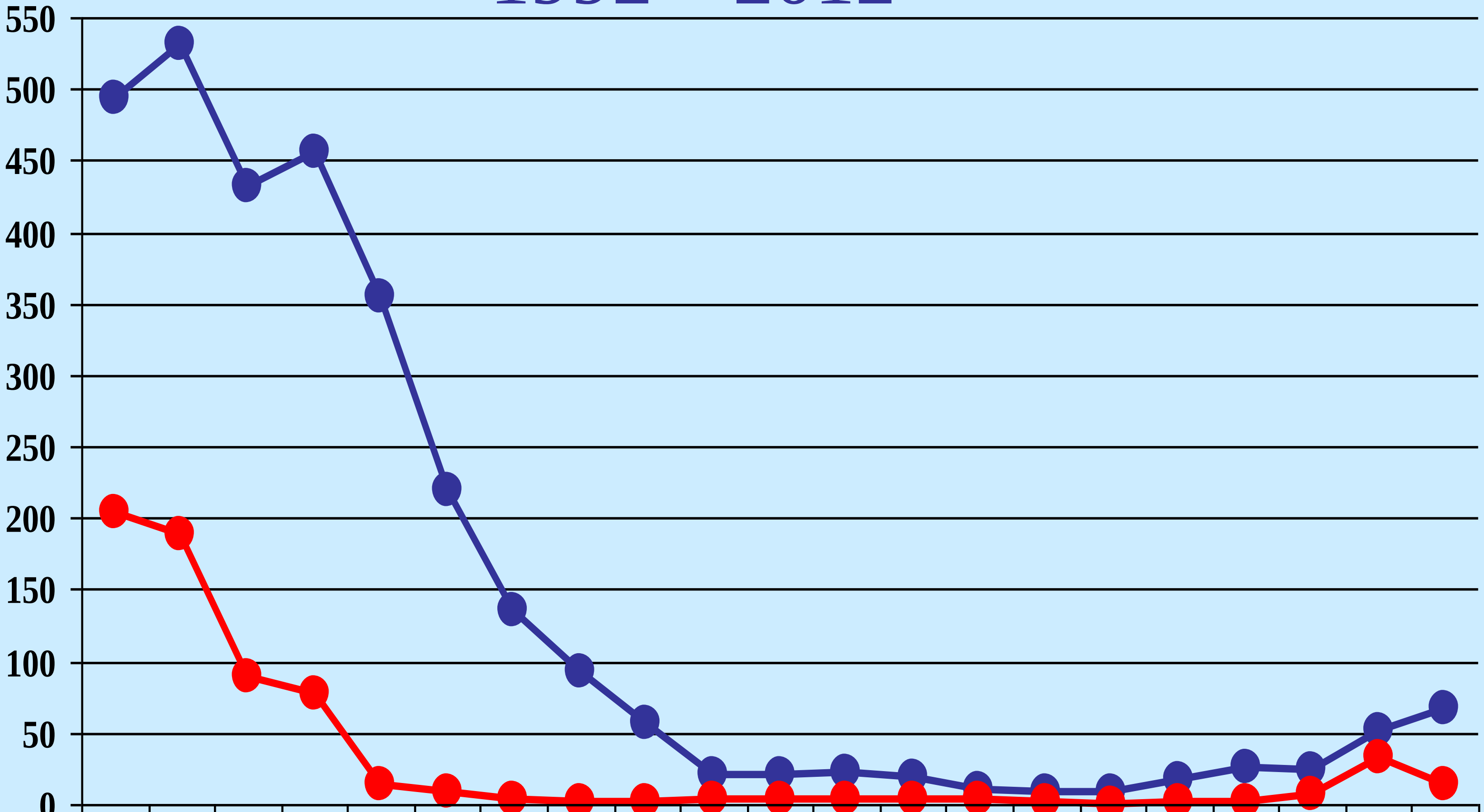
Resolving Professional Liability Claims

- Pre-Litigation Settlement
  - Confidentiality agreement to exchange documents
  - Mediated or informal
  - Cost-effective
- Litigation
  - FDIC considers settlement throughout litigation

No Cost-Effective PL Claim? Potential Defendants May Still Face Actions

- Regardless of whether claims are meritorious and cost-effective, claims may be referred to other groups or agencies
  - Primary Regulator
  - FDIC's Enforcement Section
  - Department of Justice
  - FDIC's Financial Crimes Unit

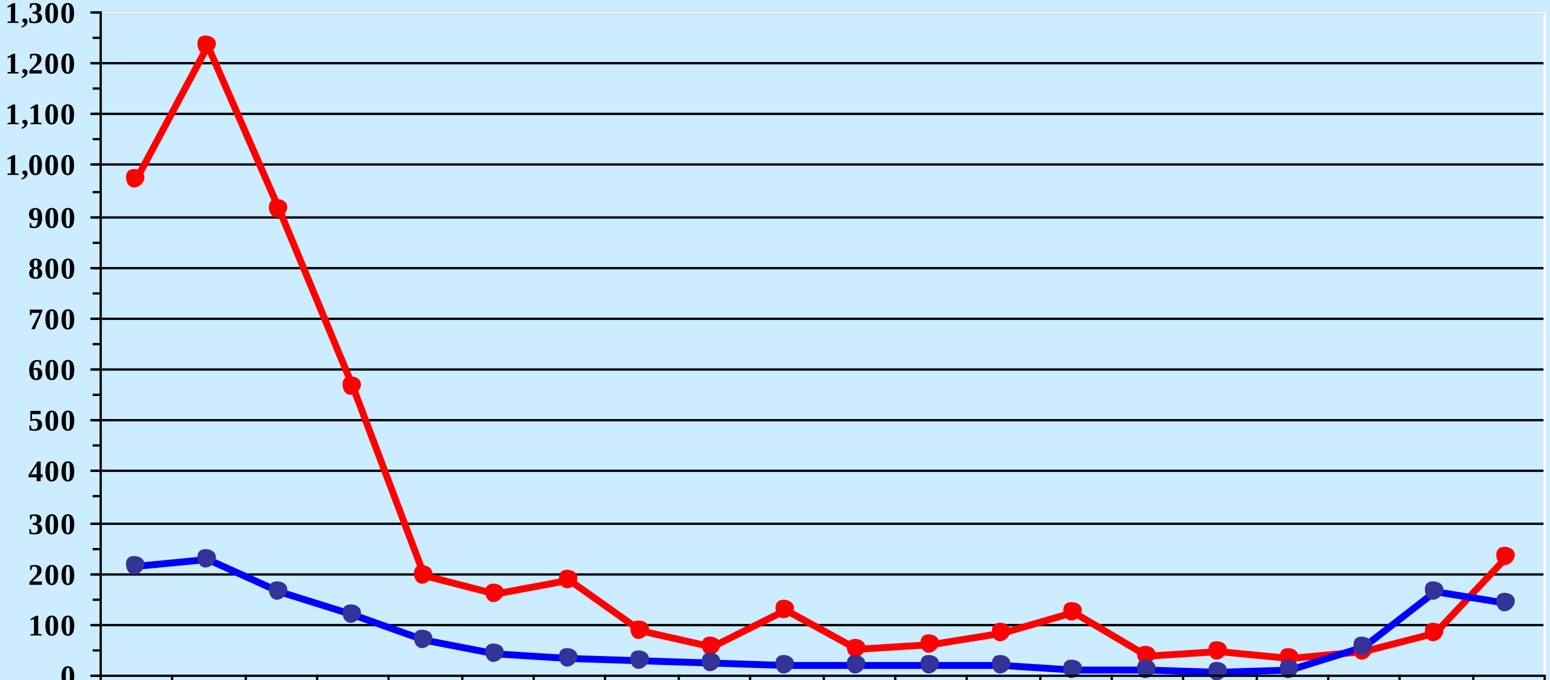
FDIC Professional Liability Civil Actions*
1992 – 2012



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
FDIC Pending*	493	531	432	455	354	219	136	93	56	21	20	22	19	11	8	9	17	25	24	52	67
FDIC Filed*	204	189	89	77	13	9	3	1	2	4	3	4	3	3	2	0	1	1	6	33	14

***Includes RTC for 1992-1995. As of January 1, 1996, RTC was abolished and FDIC handled all RTC cases.**
Figures do not include mortgage malpractice and fraud or other related matters such as individual bankruptcies, arbitrations or garnishments.
Includes pending and filed cases through December 31, 2011.
Data for 2012 are as of May 31, 2012

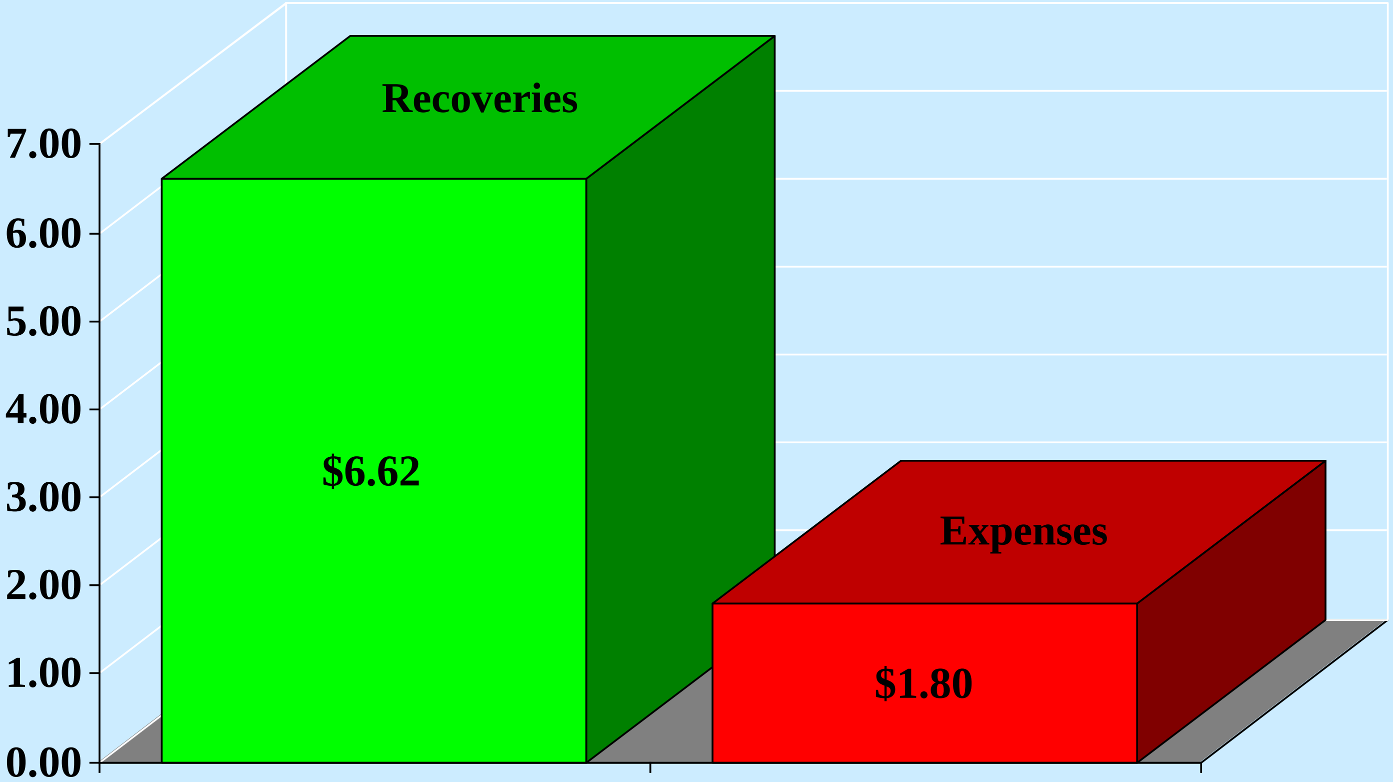
FDIC Professional Liability Program Recoveries and Expenses 1992 – 2011* (in $Millions)



	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
FDIC Recoveries*	972.6	1231	910	564	195.9	156.8	186.5	84.2	54.4	128.6	49.1	59.9	79	122.2	34.5	47.1	31.3	47.1	79.4	231.9
FDIC Expenses*	211.6	223.6	164.4	117.4	67.9	39.2	31.9	26.4	20.7	16	19.1	20.2	16.2	8.5	7.2	5	9.7	52.9	160.8	139.5

***Includes RTC recoveries and expenses from 1992-1995**
1992-1995 expenses are outside counsel only
Includes 1992-2006 Drexel-Milken recoveries and expenses
Includes recoveries and expenses through December 31, 2011

Professional Liability Recoveries and Expenses 1986 - 2012* (in $Billions)



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Dodd-Frank Act

- Enacted on July 21, 2010
- Orderly Liquidation Outside of the Bankruptcy Code
  - Financial Stability Oversight Counsel (FSOC)
  - Systemically Important Financial Institutions (SIFIs)
  - Secretary of the Treasury
  - Expedited Judicial Review

Dodd-Frank Act
Executive Compensation Claw-Back

- Dodd-Frank Act, § 210(s)
- FDIC May Recover Compensation
  - From current and former senior executives and directors <u>if</u>
  - "substantially responsible for the failed condition of the covered financial company."
  - Recovery Period: two years prior to failure
- Implementing Regulation: 12 C.F.R. § 380.7 (Aug. 15, 2011)

Dodd-Frank Act – § 1471

- "Higher-risk mortgage": is not a "qualified mortgage" and has interest rate above prime
- Lender may not make a higher-risk mortgage without an appraisal and an interior inspection by a licensed appraiser
- A second appraisal is required for a higher-risk mortgage on property purchased within the previous 180 days
- Lender must provide free copy of each appraisal to the borrower at least 3 days before closing
- Penalties: $2,000 for a willful violation

Dodd-Frank Act – § 1472

- Lists Appraisal Independence criteria
- No direct/indirect interest in the property appraised
- Mandatory reporting of violations to State
- Penalties: $10,000 for first violation; $20,000 for second and subsequent violations

Dodd-Frank Act – § 1473

- Specifies appraisal requirements for federally regulated lenders
- Enhances authority of Appraisal Subcommittee
- Establishes minimum requirements for AMCs
- Quality control standards for AVMs
- Lender must provide free copy of appraisal at least 3 days before closing
- Broker price opinion can’t be primary basis for determining value

Dodd-Frank Act – §§ 1474 & 1475

- Amends ECOA to require lender to provide borrower at least 3 days before closing a free copy of appraisal and notice of right to receive the copy

- Amends RESPA to require disclosure of appraisal fees and fees charged by AMCs

Dodd-Frank Act – § 1476

- Requires GAO to conduct studies on:
    1. impact of appraisal methods
    2. Home Valuation Code of Conduct
    3. Appraisal Subcommittee functions
- GAO published its study on #1 and #2 in July 2011
- GAO published its study on #3 in January 2012

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Opportunities for Appraisers to Assist the FDIC

- The FDIC uses Appraisal Management Contractors (“AMCs”) to oversee all appraisal services for a particular receivership
- Appraisal Types
  - Real Estate
  - Personal Property

Appraisers Assisting the FDIC

- Appraisal Standards
  - The FDIC appraisal regulation, 12 C.F.R. Part 323
  - USPAP
  - The specific Statement of Work

- Common Problems
  - Poor property information given to AMCs
  - Owners/Occupants will not grant access to property

Opportunities for Appraisers to Assist the FDIC

- The FDIC's Professional Liability Unit retains appraisal experts to
  - Analyze appraisals during investigations
  - Perform review appraisals
  - Serve as expert witnesses at trial

Advice for Appraisers Entering Banking

- Comply with USPAP standards
- Confirm and consider all relevant facts
- Use appropriate comparables and make needed adjustments
- Do not bend the rules to get an appraisal fee

QUESTIONS?