

October 20, 2010

Experts: FDIC faces challenge in going after banks

Wayne Tompkins

An attorney for former BankUnited executives promises to come out swinging if they are targeted by lawsuits from federal banking regulators seeking to recover losses.

Fifty unnamed executives and directors of failed banks are facing legal action from the Federal Deposit Insurance Corp., which wants to recover \$1 billion in losses to its Deposit Insurance Fund.

But South Florida banking attorneys are skeptical the federal regulator will ultimately be successful in recovering much money. Most cases are likely to be settled, and in some cases a failed bank's director and officers insurance policies will not cover intentional misconduct.

"The biggest obstacle for the FDIC happens to be the biggest benefit to the executives of failed banks: that is the ability to prove negligence or wrongdoing," said Carlos Arboleda, executive director of the national banking and financial services group at Stephen James Associates.

The FDIC has shuttered 300 banks nationwide since January 2007 at a cost of just over \$73 billion to its Deposit Insurance Fund. BankUnited FSB, which failed in May 2009 at an estimated cost of \$5.7 billion to the fund, and a number of smaller South Florida community banks have been among them.

Miami commercial litigation attorney Thomas Tew, who in March successfully defended executives of holding company BankUnited Financial from a class action led by institutional

investors, said he is ready to fight for any of his banking clients should the FDIC move against them.

"I plan to put the government right in the cross hairs if they attempt to revise history and argue that my officers and directors were on this underwriting lark of their own, when in fact the policies, the products, the asset quality was rated constantly by the regulatory agencies as top quality," the Tew Cardenas partner said. "The government's bell rang, and everyone was told, 'You can go make more loans.' It was a failure across the board, but the people who are going to end up taking it in the shorts are the officers and directors of the banks."

Tew said that such lawsuits will result in "a very interesting analysis" of the actions of the Office of Thrift Supervision, which regulated a number of failed banks including BankUnited FSB.

The OTS in some inspector general's reports has been lambasted for its lax regulatory oversight, most notably in the Treasury Department's recent audit of BankUnited's failure.

"You see institutions that received high marks from the OTS now getting beat up in the political arena by the FDIC, while their sister agency had approved the very same practices through their oversight inspections it will now be the subject matter of litigation," Tew said. "That's going to be thrown right back in their face, and we plan to do so."

Tew said that, looking at the clients he represents and the asset quality scores that the OTS gave them, "you'll see very strong marks, and then the FDIC comes in and says you're a bunch of negligent bumbling fools. They're going to be met by the investigative reports of their own sister agency."

Bowman Brown, a partner and banking attorney at Shutts & Bowen, said the Florida standard for a finding of liability for officers and directors is a gross negligence standard, meaning they "would practically have to be reckless."

Regulators, however, are forging ahead.

"We're ready to go," FDIC acting general counsel Richard Osterman told Bloomberg News earlier this month. "We could walk into court tomorrow and file the lawsuits."

Seeking to avoid costly litigation, Osterman said the agency has held off court action while conducting settlement talks with executives whose actions may have led to bank collapses. He said the typical audit of a failed bank takes about 18 months, and most are still in progress.

'Suppressed' Standards

Another common thread in banks' defense will be the pressure under which the federal government put lenders to make home ownership available to more and more people.

"It's a noble cause, but [the federal government] suppressed and pushed down the underwriting standards," Tew said. "There were people who should have stayed renters and were put into homes who ended up owing most of these mortgages that are now in foreclosure."

The coming wave of lawsuits echoes nearly 500 failed institutions whose executives were sued by the FDIC during the late '80s savings and loan crisis.

"The FDIC is very likely to recoup some monies from these lawsuits if they can prove wrongdoing or negligence, but I would be surprised if more than a third of those cases got to court instead of agreeing to some sort of settlement, either from the insurance, the individual or both," Arboleda said. "Almost 25 percent of executives from the 1,800 S&Ls that failed 20 years ago were sued, so there is certainly a record by the FDIC to go after them where they feel there is merit."

Brown said he believed that bank officers and directors generally acted in good faith.

"They didn't want to make bad loans, I think in most cases they used their best judgment to make loans that they judged to be good loans," he said. "Who foresaw the kind of disaster that happened in Florida's real estate economy?"

Early in its process of reviewing failed banks, FDIC investigators will determine if litigation is possible to recover losses to its insurance fund. The agency sends out a letter to officers and directors telling them that a lawsuit could be on the way.

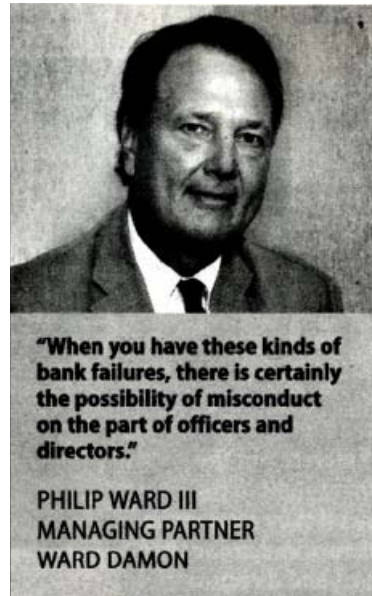
BankUnited Financial received such a letter last year, as part of a November motion the FDIC filed in the company's bankruptcy case.

Addressed to 15 BankUnited directors and officers, the FDIC's letter alleged that BankUnited executives breached their fiduciary duties and that the company "blindly made loans to borrowers who, for the most part, were un-creditworthy, creating an unduly high risk of inevitable failure when the housing market began to decline."

'Questionable conduct'

Attorneys said at this phase of the financial crisis, such legal maneuverings are to be expected.

"When you have these kinds of bank failures, there is certainly the possibility of misconduct on the part of officers and directors," said Philip Ward III, banking attorney and managing partner at Ward Damon in West Palm Beach. "We've been involved in some foreclosure actions where there appears to be some questionable conduct that occurred. You look at the value of the collateral, and you can't understand how the loan could have been made."



Ward recalled that during the S&L crisis, regulators moved not only against directors and officers but also attorneys.

"If there is intentional misconduct, then oftentimes the D&O insurance will not cover potential losses," he said. "If the bank failed, there certainly isn't anything there to go after, and for the directors and officers, it becomes a question of what their financial strength is. They may have their own private wealth."

John Hogan, who served as chief of staff to U.S. Attorney General Janet Reno, said any Monday morning quarterbacking simply because a bank has had trouble in the economy is likely to fail.

"The devil is going to be in the details, in how they proceed and the strength of the cases they choose to litigate," said Hogan, chair of Holland & Knight's South Florida litigation practice group

and before that a veteran prosecutor. "If there are clear examples of fraud and other sorts of clear violations of the law, they will do well."

Lewis Cohen, a veteran banking attorney and founding partner of Cohen & Bobotas, said the FDIC must be selective in its targets.

Insurance Coverage

"They do have a threshold standard to overcome in order to hold an officer or director liable for damages," he said. "Generally, they must have done something more than simply exercise poor business judgment."

Tew said the fate of other cases will be driven by the insurance coverage that may or may not be in place by the various failed institutions at the time they failed. "Unfortunately, many of the smaller institutions, when they renewed the officer and director coverage, were faced with policies that included regulatory exclusions," he said. "That's a magic term, which means they were paying their premiums for no coverage in the event that the FDIC would come after them for negligence in managing the bank."

Tew said that based on experience going back to the old Resolution Trust Corp. formed in the wake of the late '80s savings and loan crisis, there will be an analysis of coverage, and they will want to look at the personal financial condition of the directors as well.

"But in Florida, with our pro-debtor laws, most of these recoveries will be driven by the insurance coverage," he said "That doesn't mean the government won't look to [personal assets]. My experience has been that any significant recovery would be in the areas of the coverage."

Egregious Conduct

Of course, if a banker's conduct is egregious enough, civil penalties will be the worst of his or her worries.

"I would be shocked if we don't see some criminal charges," Ward said. "Looking back at the S&L crisis, there were people who went to jail — both bank officers and attorneys."

Peter Homer, a business law litigator and founding partner of Homer Bonner, said that after the S&L crisis, there were instances where civil litigation against bankers was appropriate.

"But there were lots of other instances where they were either inappropriate or poorly thought through," he said. "People within the agency who were not lawyers, not economists, who were making these decisions to prosecute these cases."

External considerations like the availability of insurance too often drove such cases, Homer said.

"The government has hired several outside law firms to pursue these matters, so whether these firms will be tasked and at what hourly rate to pursue collections of \$100,000 or \$200,000, I don't know," Tew said.

"That would assume they could get a judgment and settle it," he said. "A lot of this, no doubt, is going to be driven by political considerations."

Wayne Tompkins can be reached at wtompkins@alm.com or at (305) 347-6645.