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BANKING REPORT

Enforcement Review

Enforcement

2010 Review of Enforcement Actions: A Hardened Government Attitude

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The number of formal enforcement actions issued by the federal banking agencies exploded again in 2010, following a record setting year in 2009 in which the federal banking agencies issued more than 1000 formal enforcement actions for the first time.[1] In 2010, the federal banking agencies issued approximately 1500 formal enforcement actions, which was a significant increase over the approximately 1100 formal enforcement actions issued in 2009.[2]

This historic high level of enforcement activity by the federal banking agencies reflects the continuation of a very challenging business environment for the banking industry as a whole, despite the fact that many depository institutions appear to have made significant strides since the depths of the financial crisis to shore up capital, bulk up reserves, and improve liquidity. It may also reflect an increased willingness on the part of the federal banking agencies to issue formal enforcement actions against institutions prior to their failure, following congressional pressure and numerous reports stating that banking regulators were too slow to take such actions against failing institutions in the recent past.

During the past three years, over 3000 formal enforcement actions, including almost 700 assessments of civil money penalties ("CMPs"), have been issued by the federal banking agencies.[3] In addition, more than 2500 informal memoranda of understanding have reportedly been issued by the federal banking agencies during that period of time.[4] While these statistics do not exactly translate into the number of U.S. depository institutions that have recently been subject to an enforcement order, because of repetitive actions at the same institution and orders directed at individuals, they do suggest that a very significant percentage of U.S. depository institutions have been the subject of some form of formal or informal bank regulatory enforcement action during the past three years. As expected, the overwhelming focus of bank enforcement activity since the beginning of the recent financial crisis has

[1] As used herein, references to the federal banking agencies or similar references refer to the Board of Governors of the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").

[2] See our prior article, *Enforcement Actions Against Banks Exceeded 1000 for First Time in 2009*, 94 Banking Rep. (BNA) 444 (Mar. 2, 2010) (94 BBR 444, 3/2/10).

[3] These figures do not include informal enforcement actions issued by the federal banking agencies, which are not publicly disclosed by the agencies.

[4] *Agencies' Orders to Banks Set Mark in '10*, American Banker (February 11, 2011).

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been on the fundamental building blocks of safety and soundness, including capital, asset quality, management, earnings and liquidity. With regard to liquidity, we have seen a distinct regulatory shift over the past couple of years that has thrown the internet and wholesale funding model into disrepute with the banking agencies, leading to significant pressure on banking institutions using such funding that are unable to transform overnight into retail banks.

The historic high level of bank enforcement activity is not the only bad news for the banking industry. The federal banking agencies, the Special Inspector General for TARP (''SIGTARP''), the U.S. Department of Justice (''DOJ''), the Federal Housing Finance Agency (''FHFA''), and other state and federal agencies are actively engaged in investigations regarding the mortgage finance industry and are seeking to identify institutions and individuals who played a role in the functional collapse of private financial markets. The principal focus of these inquiries is mortgage fraud, whether it be by the lender, the borrower, or the middleman, and servicing defects, whether they relate to filings, servicing, or foreclosure. In that regard, the ''robo-signing'' problems in the industry have been well chronicled, as have the attempts by the 50 state attorneys general to investigate and assert claims against the largest mortgage servicers in the country.

At the same time, the increasing number of lawsuits being brought by investors and others asserting fraud in the issuance and sale of mortgage-backed securities and related synthetic derivative instruments is further complicating an already treacherous landscape. In combination with criminal prosecutions that are beginning to appear and more than 140 outstanding investigations by SIGTARP, a perfect storm for bank enforcement has clearly emerged.

Formal Enforcement Actions: 2005 – 2010

Year	FDIC	FRB	OCC	OTS	Total
2010	767	280	250	227	1524
2009	510	191	188	206	1095
2008	225	54	150	58	488
2007	181	34	111	44	370
2006	200	28	139	54	421
2005	147	58	159	61	426

Source: FDIC, FRB, OCC and OTS data.

Civil Money Penalties: 2005 - 2010

Year	FDIC	FRB	OCC	OTS	Total
2010	211	3	54	50	318
2009	156	8	30	26	220
2008	101	5	30	11	147
2007	95	11	59	5	170
2006	89	7	68	10	174
2005	60	14	77	19	151

Source: FDIC, FRB, OCC and OTS data.

The Bottom Line of the Recent Enforcement Trend

The blizzard of cases and related settlements indicate specific trends in bank enforcement activity, including a hardened government attitude — which is entirely expected — with regard to the negotiation of settlement orders and the breadth and scope of their provisions. Our review of bank enforcement activity, litigation, and other developments in 2010 and over the past several years reveals the following key enforcement action trends:

1. The enforcement tools (both formal and informal) of the federal banking agencies are being liberally deployed to deal with capital and management deficiencies.

2. Consumer financial protection will occupy a high priority among the banking agencies in light of the criticisms that have been leveled against them in the recent past and the creation of the Consumer Financial Protection Bureau (''CFPB'') under the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'').

3. Agency inspectors general, including SIGTARP, are active in the post-crisis environment and are investigating a variety of civil and criminal cases (see further discussion below).

4. Mortgage fraud will be its own center of enforcement activity for years to come, throwing a net around all players in the chain of origination, servicing, and securitization at both the federal and state levels.

5. Multi-agency actions can be expected to be the norm over the next several years, increasing the complexity quotient with regard to defenses and global settlements, particularly when parallel criminal action is initiated.

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6. Impending bank enforcement is usually indicated by (i) a continuing failure to adhere to examination and regulatory recommendations or directives, (ii) significant losses and/or a marked deterioration in the quality of assets, and (iii) significant accounting irregularities, particularly when they result in news stories and internal investigations.

7. In many areas, particularly BSA/AML, self-reporting continues to be a way to mitigate the ferocity of enforcement and the size of assessments and fines.

8. Many enforcement actions will include both a joint civil and criminal investigation, a factor that adds Fifth Amendment considerations to a party's willingness to testify or cooperate with regulators.

9. Derivatives and swaps have and will continue to be a focus, particularly as Title VII of the Dodd-Frank Act establishes trading standards and exchanges and promotes transparency in the marketplace.

10. The federal banking agencies have increased their enforcement staffs which, with the addition of inspectors general, the DOJ's task forces and other state and federal agencies, will likely result in the continued high level of enforcement activity.

Key Strategies to Complying with Bank Enforcement Actions in the Current Environment

A key priority for the directors and management of a banking institution subject to an enforcement action is to restore credibility with the institution's regulator. Our experience counseling clients in this area suggests that directors and management may sometimes fail to fully appreciate the extent to which they have lost the confidence of the institution's regulator and, as a result, may significantly underestimate how difficult it will be to convince the institution's regulator that they are the ones who can and should right the ship.

To restore credibility, the institution's board of directors and management must be willing to engage in an open and constructive dialogue with the regulatory agency to communicate the shared goal of placing the institution on a safer and sounder footing. In that regard, the directors and management should proactively seek opportunities to meet with the institution's regulator on a regular basis, preferably in person, and to candidly discuss issues and resolve concerns.

While engaging in a constructive dialogue with an institution's regulator is important, the board and management should resist the temptation simply to agree to any and all demands made by the institution's regulator with respect to remedial actions to be taken by the institution or the terms of an enforcement order. Our experience suggests that the terms of a proposed enforcement action are nearly always negotiable, even in circumstances where a banking agency initially suggests otherwise. A particularly difficult and thorny issue for negotiation is a demand made by the institution's regulator that the board consent to the appointment of a receiver if the institution fails to raise capital by a sufficient amount by a specified deadline. As the number of bank failures has increased, the federal banking agencies have increased their demands for such provisions to be included in enforcement orders, which significantly increases the stakes for all parties involved.

Following the negotiation and execution of an enforcement order, the institution's board and management will need to dedicate sufficient internal resources to ensure that the institution complies with all the terms of the enforcement order by the specified deadlines. Many recent enforcement actions have contained a comprehensive set of demands and detailed requirements that require the institution to prepare various reports, plans and policies.[5] In addition to assigning sufficient internal resources to ensure compliance with the enforcement order, an institution's board and management should also give serious consideration to hiring one or more independent consultants to assist the institution in its compliance efforts during this challenging period. Outside expertise may be needed in one or more areas, including asset valuation, capital planning, management assessment, and risk management. With respect to capital, many enforcement actions in the current environment have imposed heightened capital requirements, often to a level well above that otherwise required to be considered adequately capitalized for prompt corrective action requirements. Complying with demands for additional capital will often require the board and management of the institution to adopt a credible and realistic strategy for raising new capital from outside investors, which is likely to require the hiring of an investment banker to help to find prospective investors.

A particularly difficult and thorny issue for negotiation is a demand made by the institution's regulator that the board consent to the appointment of a receiver if the institution fails to raise capital by a sufficient amount by a specified deadline.

It is critical that the board and management ensure that all terms of an enforcement order are met by the specified deadlines. The failure to meet any such deadlines (i) will undermine the efforts made by the institution's board and management to restore credibility with the regulator, (ii) may expose individuals to the assessment of CMPs, and (iii), in the most serious of circumstances, may result in the institution being placed on the conveyor belt to receivership and the directors and officers of the institution being subject to litigation by the FDIC. Our experience working with troubled institutions over the past several years has been that once an institution is placed on the conveyor belt to receivership, and the FDIC starts the bidding process to sell the institution's assets, it is extremely difficult to convince

[5] For example, an institution may be required to prepare, among others, a capital plan, a strategic/business plan, a management plan, a revised loan policy, an asset/liability management policy, and/or a plan to improve and sustain earnings. If required, such plans and policies are typically required to be submitted for regulatory approval within 30 to 120 days from the date of the enforcement action.

the federal banking agencies to provide the board and management with additional time to right the ship, even where additional time seems entirely warranted by the facts and circumstances.

The directors of an institution subject to an enforcement order should expect that high demands will be made upon them during the pendency of the order. At a minimum, some or all of the board members, particularly outside directors, may need to participate in special board meetings to, among other things, approve an overall strategy to meet regulatory goals and deadlines, to oversee the efforts of management, and to guide regulatory responses. The enforcement action itself may specifically require that the board form a compliance committee consisting of outside directors to ensure compliance with the terms the order.

While the board and management of an institution subject to an enforcement order will want to ensure that the enforcement order terminates as soon as possible, it should not expect that the enforcement order will be lifted for at least one or two examination cycles. Our experience over the past several years suggests that the federal banking agencies are generally unwilling to terminate an enforcement action prior to such time, even if presented with credible evidence that the institution has fully complied with all of its requirements.

Consumer-Focused Enforcement Actions

While safety and soundness and capital concerns account for the vast bulk of the enforcement actions issued over the past few years, the federal banking agencies also remain focused on ensuring that banking institutions comply with consumer protection laws and regulation. The newly created CFPB will likely ensure that consumer-focused enforcement actions will be at the forefront of enforcement activity for the foreseeable future.

In February 2010, the OCC entered into a written agreement with a credit card bank, pursuant to which the bank agreed to provide redress to eligible customers with regard to credit-card account-closing processes. The OCC alleged that the bank assessed annual membership fees on accounts with no outstanding balance owed, after customers had requested that the accounts be closed.

In April 2010, the OCC entered into a written agreement with a national bank pursuant to which the bank agreed to provide restitution totaling $5.1 million to more than 60,000 customers allegedly adversely affected by the bank's account relationships with a third-party payment processor and several telemarketers and internet merchants. The bank also agreed to pay a CMP of $100,000 and to develop new policies and procedures.

In April 2010, the OTS entered into a cease and desist order (''C&D'') with a thrift and imposed a CMP of $400,000 on the thrift in connection with allegations that the thrift charged excessive fees for overdraft protection on bank accounts. Under the terms of the enforcement order, the thrift also agreed to deposit more than $12 million into an account to reimburse current and former customers who were allegedly misled about the cost of overdraft protection and charged excessive overdraft-protection fees. At the same time, the OTS proposed guidance to its examiners and OTS-regulated institutions about overdraft practices. The guidance addresses unfair or deceptive acts or practices (''UDAPs'') prohibited by the Federal Trade Commission Act (''FTC Act''), as well as practices that violate other federal laws or regulations.

In March 2010, FinCEN assessed the largest CMP ($110 million) ever imposed against a financial institution for violations of the BSA.

In May 2010, the OTS issued a new section to its Examination Handbook that provides guidance for evaluating whether federal thrifts have engaged in UDAPs in violation of section 5 of the FTC Act.[6] The new section explains (i) the standards that the OTS and other federal regulatory agencies use to assess whether an act or practice is unfair or deceptive; (ii) the process for determining whether an institution is engaging in UDAPs; and (iii) examples of enforcement actions taken under the FTC Act. The guidance also clarifies that acts or practices that violate the FTC Act may also violate other statutes, such as the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Fair Housing Act, and the Fair Debt Collection Practices Act.

In August 2010, the FDIC established a new division of depositor and consumer protection to ensure that banks comply with consumer protection and fair lending statutes and regulations. While the newly-created CFPB will be responsible for promulgating consumer protection rules, the FDIC has responsibility for enforcing such rules for certain banks with $10 billion or less in assets and to perform its traditional depositor protection function. The FDIC stated that the new division will also house FDIC staff and resources devoted to answering questions and promoting public understanding of deposit insurance and the use of FDIC-insured bank accounts.

Bank Secrecy Act Enforcement

Last year also marked the 40th anniversary of the Bank Secrecy Act of 1970 (''BSA'') and the 20th anniversary of the establishment of the Financial Crimes Enforcement Network (''FinCEN''). In 2010, FinCEN engaged in a number of regulatory initiatives, including announcing a final rule that will reorganize its rules and regulations into a new, tenth chapter of Title 31 of the Code of Federal Regulations (''Title 31 Chapter X – Financial Crimes Enforcement Network''). The reorganization is not intended to make any substantive changes to regulations implementing the BSA, but instead to enhance industry compliance by making the regulations more understandable. FinCEN also initiated several notable enforcement actions in 2010.

In March 2010, FinCEN assessed the largest CMP ($110 million) ever imposed against a financial institution for violations of the BSA. The action against the bank was part of a joint investigation among FinCEN, the U.S. Attorney's Office for the Southern District of Florida, the OCC, the Drug Enforcement Agency, and

[6] OTS Regulatory Bulletin (RB 37-53) *Unfair or Deceptive Acts or Practices–FTC Act* (May 7, 2010).

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the Internal Revenue Service-Criminal Investigation Division. The joint investigation determined that the bank had violated various anti-money laundering (AML) program requirements and failed to implement an effective AML program reasonably designed to identify and report transactions that exhibited indicia of money laundering or other suspicious activity, considering the types of products and services offered by the bank, the volume and scope of its business, and the nature of its customers. As a result, the investigation determined that the bank failed to timely file thousands of SARs and CTRs, thus greatly diminishing the value of the reports to law enforcement and regulatory agencies.

In May 2010, FinCEN and the FDIC assessed concurrent CMPs of $25,000 against a bank that allegedly failed to implement an adequate AML program and monitor accounts for suspicious activity, relative to the types of products and services, volume of business, and nature of customers at the bank.

In June 2010, FinCEN assessed a CMP of $1 million against a bank in connection with allegations that the bank lacked internal controls, had unqualified BSA compliance personnel, relatively nonexistent training, and deficient independent testing that resulted in a wholly ineffective BSA compliance program. As a result, the bank allegedly failed to file a substantial number of CTRs and SARs in an accurate and timely manner. The investigation was part of a coordinated effort with the U.S. Attorney's Office, the Asset Forfeiture and Money Laundering Section of the DOJ, and the OTS. FinCEN's assessment was in addition to forfeiture and CMP actions respectively taken by the DOJ and OTS against the bank in March 2010.

BSA Filings by Type, Fiscal Years 2008 – 2010

Type of Form	FY 2008	FY 2009	FY 2010
Currency Transaction Report	16,082,776	14,909,716	14,065,871
Suspicious Activity Report	1,318,984	1,321,848	1,319,984
Report of Foreign Bank and Financial Accounts	344,967	276,386	594,488
Registration of Money Services Business	21,102	19,234	20,302
Description of Exempt Person	53,675	32,117	22,990
Report of Cash Payments Over $10, 000	184,305	180,801	174,023
Total	**18,005,809**	**16,740,102**	**16,197,658**

Source: FinCEN Annual Report, Fiscal Year 2010

Other Notable Enforcement Actions

In December 2010, a national bank entered into a written agreement with OCC pursuant to which the bank agreed to pay $137 million to settle allegations that certain employees of the bank engaged in illegal conduct in connection with the marketing and sale of certain derivative financial products to municipalities and other nonprofit organizations from 1998 through January 2004. The written agreement made clear that the bank self-reported its employees' misconduct to the DOJ, had cooperated with the investigations conducted by the OCC and other federal agencies, and was taking steps to enhance and strengthen its policies, procedures, systems, and controls related to the sale of certain derivative financial products to its counterparties.

The bank also agreed, among other things, to develop detailed written policies and procedures designed to ensure compliance with safe and sound banking practices, and with laws and regulations governing the marketing and sale of competitively bid derivative financial products to municipalities and other nonprofit organizations. Such policies and procedures were to include processes designed to detect and prevent potential collusion, bid-rigging, price fixing, or other improper activity, and to ensure the accuracy of books and records related to these transactions. The written agreement also required the bank to deposit into a segregated deposit account an amount of not less than $9,217,218, which represented the total profits recorded by the bank for certain collateralized certificates of deposit transactions engaged in with certain identified municipalities and counterparties. The bank was required to pay each listed counterparty an amount specified in an appendix to the written agreement.

In a separate, coordinated action, the bank's holding company entered into a written agreement with the FRB to address issues associated with alleged anticompetitive activities at the bank by certain employees in conjunction with the sale of certain derivative products to municipalities and other nonprofit organizations from 1998 to 2003. The agreement required the bank to, among other things, submit a written plan to strengthen board oversight of its compliance risk management program as it relates to competitively bid transactions.

SIGTARP

In December 2010, SIGTARP marked its second anniversary. SIGTARP was established in December 2008 pursuant to Section 121 of the Emergency Economic Stabilization Act of 2008 (''EESA''), which was subsequently amended by the Special Inspector General for the Troubled Asset Relief Program Act of 2009. The Special Inspector General is charged with the responsibility to, among other things, conduct, supervise, and coordinate audits and investigations of any actions taken under the Troubled Asset Relief Program (''TARP''), or as deemed appropriate by the Special Inspector General. In carrying out those duties, SIGTARP has the authority set forth in Section 6 of the Inspector General Act of 1978, including the power to issue subpoenas.

As of December 31, 2010, SIGTARP reported charging 45 individuals civilly or criminally with fraud, of whom 13 have been criminally convicted. In addition, SIGTARP reported 142 ongoing criminal or civil investigations (including 64 investigations into executives at financial institutions that applied for and/or received TARP funding through TARP's Capital Purchase Program). These investigations, many of which are conducted in partnership with other law enforcement agencies, concern suspected TARP fraud, accounting fraud, securities fraud, insider trading, bank fraud, mortgage fraud, mortgage servicer misconduct, false statements, obstruction of justice, theft of trade secrets, money laundering, and tax-related investigations. Although much of SIGTARP's investigative activity remains confidential, there has been significant public developments in several of SIGTARP's investigations. Notable actions in 2010 include:

Omni National Bank

On March 27, 2009, the FDIC was appointed receiver for Omni National Bank, Atlanta, Georgia (''Omni''). Prior to its failure, the bank had applied for, but did not receive, TARP funds under the Capital Purchase Program. SIGTARP has participated in several investigations concerning Omni resulting in criminal charges as part of an interagency mortgage fraud task force, which also includes the FDIC-OIG, Housing and Urban Development Office of Inspector General (''HUD-OIG''), the Postal Inspection Services, and the Federal Bureau of Investigation (''FBI''). On January 14, 2010, Omni's former executive vice president and second largest shareholder, pled guilty in Federal district court to charges of causing material false entries that overvalued the bank assets in the books, reports, and statements of Omni. The defendant and others at Omni failed to disclose many exceptions to their policies and procedures which resulted in Omni being exposed to a greater risk of loss. Practices that went unreported included: diversion of escrowed loan proceeds, excessive credit concentrations to a single borrower, funding additional loans for Omni foreclosures at ever-increasing amounts, and failing to create sufficient reserves for questionable loans or to properly record them on Omni's books and records. Other Omni defendants were also charged with criminal wrongdoing, including one defendant who was sentenced on April 1, 2010, to 16 years in prison on charges of conspiracy to commit bank, mail, wire, and bankruptcy fraud.

Taylor, Bean & Whitaker Mortgage Corporation and Colonial Bancgroup

On June 15, 2010, the former chairman and majority owner of Taylor Bean & Whitaker Mortgage Corporation (''TBW'') was arrested by SIGTARP agents and others and charged in U.S. District Court for the Eastern District of Virginia with offenses including bank fraud, wire fraud, and securities fraud. It was alleged that defendant and others at both TBW and Colonial Bank committed a massive multi-billion dollar accounting fraud that included an attempt to fraudulently acquire more than $550 million in TARP funds for Colonial Bank. SIGTARP was joined in this investigation by the FBI, HUD-OIG, and the FDIC-OIG. The Securities and Exchange Commission's (''SEC'') complaint against the defendant alleged securities fraud and other violations of the federal securities law. Among other allegations, the SEC alleged that the defendant engaged in a pattern of fraudulent conduct for the purpose of selling at least $1.5 billion of fictitious and impaired residential mortgage loans from TBW to Colonial Bank, and for Colonial Bank, and its publicly traded parent company, The Colonial BancGroup, Inc., to falsely record these fictitious and impaired mortgage loans as high quality assets.

FHFA Office of Inspector General

The FHFA Office of Inspector General (''FHFA-OIG'') was established by the Housing and Economic Recovery Act of 2008 and commenced operations in October 2010 following the swearing-in of its first Inspector General. The FHFA-OIG is tasked with, among other things, investigating and prosecuting those responsible for fraud, waste or abuse in FHFA's programs. Its Office of Investigations investigates allegations of criminal misconduct involving the programs and operations of the FHFA, Fannie Mae, Freddie Mac, and the twelve Federal Home Loan Banks. In circumstances were criminal activity or fraud is suspected, the FHFA-OIG may refer the matter to the DOJ for possible prosecution or recovery of monetary damages and penalties.

As of December 31, 2010, SIGTARP reported charging 45 individuals civilly or criminally with fraud, of whom 13 have been criminally convicted.

The FHFA-OIG has reported that it has opened numerous nonpublic criminal and civil investigations, involving such issues as fraud, accounting fraud, mail fraud, wire fraud, securities fraud, self-dealing, bank fraud, mortgage fraud, false statements, obstruction of justice, money laundering, and tax code violations. The FHFA-OIG was part of a task force investigating alleged fraud committed by officials at TBW in connection with the operations of Colonial Bank. The FHFA-OIG also engaged in the following activities in 2010, among others:

- ***FHFA's Internal Complaints***. The FHFA-OIG has been investigating whether the FHFA has adequate controls over the receipt, processing, and disposition of internal complaints of fraud, waste and abuse.
- ***Enterprise Executive Compensation***. The FHFA-OIG has been assessing the FHFA's oversight of Fannie Mae's and Freddie Mac's (''Enterprises'') executive compensation standards and practices.
- ***Conservatorship Exit Planning and Capacity***. The FHFA-OIG has been assessing FHFA's plans and capacity to implement the Administration's proposal to reform the Enterprises' corporate structures.
- ***FHFA's Relationship with Treasury***. The FHFA-OIG has been evaluating the nature and extent of the FHFA's relationship with the U.S. Department of Treasury and determining the impact of the relationship upon FHFA's programs and operations.
- ***Enterprise Internal Controls***. The FHFA-OIG has been evaluating FHFA's examination and supervision of the Enterprises' internal controls with respect to

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their mortgage loan servicers' foreclosure prevention and loss mitigation efforts.

In July 2010, the FHFA, in its capacity as conservator of the Enterprises announced that it issued 64 subpoenas to various entities, seeking documents related to private label mortgage-backed securities (''PLS'') in which the Enterprises invested. The subpoenas sought various loan files and transaction documents pertaining to loans securing the PLS trustees and servicers controlling or holding that documentation. The FHFA stated that the Enterprises were experiencing difficulty in obtaining the loan documents and therefore the FHFA invoked its authority under the Housing and Economic Recovery Act of 2008 to issue the subpoenas for the purpose of preserving and conserving the assets of the Enterprises.

FDIC Office of Inspector General

The FDIC OIG conducts audits, investigations, and other reviews of the FDIC's programs and operations. The FDIC-OIG's Office of Investigations conducts a nationwide program for the prevention, detection, and investigation of criminal or otherwise prohibited activity that may harm or threaten to harm the operations or integrity of the FDIC and its programs. The FDIC-OIG investigates financial institution fraud at both open and closed institutions and maintains close and continuous working relationships with the DOJ, the FBI, other Offices of Inspector General, and federal, state and local law enforcement agencies. For the twelve months ending on September 30, 2010, the FDIC-OIG reported that its investigative results included 154 indictments, 124 convictions, and approximately $220 million in fines, restitution, and asset forfeitures.

The FDIC-OIG has reported that it is actively engaged in the investigation of mortgage fraud, often as a result of its participation in a growing number of mortgage fraud task forces. According to the FDIC-OIG, mortgage fraud is a significant subset (approximately 40 percent) of its investigative workload, and mortgage fraud cases investigated by the FDIC-OIG may involve false representations, property flipping, straw buyers, stolen identities, inflated appraisals, foreclosure schemes, and seller assistance scams. Its investigations typically focus on industry professionals, such as mortgage brokers, senior executives, appraisers, attorneys, loan officers, and accountants, who perpetuate the fraud, but its investigations may also extend into more complex crime rings involving networks of individuals. The FDIC-OIG also works closely with the FDIC to identify individuals who have already committed financial institution crimes and are trying to avoid their obligations by concealing their assets and to pursue criminal investigations of these individuals. In addition to mortgage fraud, the FDIC-OIG has recently investigated cases involving bank fraud, obstructing the examination of a financial institution, embezzlement, identity theft, conspiracy to commit BSA violations, and money laundering.

The investigative workload of the FDIC-OIG has increased significantly with the increase in the number of bank failures. When a bank fails, the FDIC-OIG's investigative staff will participate during the closing of the bank, in circumstances where fraud is suspected. The FDIC-OIG investigators, working under the legal direction of an Assistant United States Attorney, and sometimes in conjunction with other federal and/or state and local investigative agencies, also will investigate the criminal misconduct identified in connection with the bank failure with the goal of prosecuting those engaged in criminal behavior and seeking restitution to the Deposit Insurance Fund.

FDIC Lawsuits Against Directors and Officers of Failed Institutions

Industry observers have been waiting to see when bank failures arising out of the recent financial crisis would produce a wave of FDIC litigation similar to that seen in the early 1990s after the savings and loan crisis. As of March 15, 2011, the FDIC reported having authorized professional liability suits against 158 individuals for D&O liability with damage claims of at least $3.57 billion.[7] To date, the FDIC has filed six lawsuits (including two lawsuits in 2010) naming 41 formers directors and officers of failed institutions as defendants. The FDIC also has authorized nine fidelity bond, attorney malpractice, and appraiser malpractice lawsuits. In addition, 183 residential malpractice and mortgage fraud lawsuits are pending, consisting of lawsuits filed and inherited by the FDIC.

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FDIC as Receiver of IndyMac Bank, F.S.B. v. Van Dellen, et. al.

On July 2, 2010, the FDIC commenced its first director and officer (''D&O'') lawsuit against any former director and/or officer of a recently failed depository institution. In its capacity as receiver of IndyMac Bank, F.S.B. (''IndyMac''), the FDIC filed suit in a federal district court in California seeking damages for alleged negligence and breach of fiduciary duties against four senior officers of IndyMac's Homebuilder Division (''HBD''). The defendants included, among others, HBD's former Chief Executive Officer, Chief Compliance Officer, and Chief Lending Officer. The complaint, which runs over 300 pages and includes 68 counts of alleged wrongdoing, centers on HBD's alleged pursuit of a high-risk growth strategy and high-risk credit underwriting strategy.

The complaint alleges that, among other things, the defendants negligently approved loans (i) where one or more of the sources of repayment of the loan were not likely to be sufficient to retire the debt; (ii) that violated applicable laws and regulations and/or Indy Mac's internal policies; (iii) to borrowers who were or should have been known to be not creditworthy and/or in financial difficulty; (iv) with inadequate or inaccurate financial information regarding the creditworthiness of

[7] See http://www.fdic.gov/bank/individual/failed/pls/index.html

the borrower and/or guarantors; (v) with inadequate appraisals; (vi) to be renewed or extended to borrowers who were not creditworthy or were known to be in financial difficulty and without any reduction in principal and without taking proper steps to obtain security or otherwise protect IndyMac's interests; (vii) negligently continuing and even expanding HBD's homebuilder lending despite knowledge of deteriorating market conditions; (viii) despite IndyMac having a high geographic concentration of loans in the same market; and (ix) where there was very little likelihood of the loan repaying within the term of the loan. The FDIC estimated in the complaint that IndyMac's losses on HBD's portfolio exceeded $500 million

FDIC as Receiver of Heritage Community Bank v. Saphir, et al.

On November 1, 2010, the FDIC commenced its second D&O lawsuit against the former directors and officers of Heritage Community Bank, Glenwood, Illinois (''Heritage'') seeking to recover losses of at least $20 million allegedly suffered by Heritage, an institution that had approximately $230 million in assets that was closed by Illinois banking regulators in February 2009. The complaint alleges that eleven of Heritage's former directors and/or officers engaged in negligence, gross negligence, and breach of fiduciary duty by, among other things, failing to properly manage and supervise Heritage's commercial real estate (''CRE'') lending program. The eleven defendants include former members of Heritage's board of directors, including five outside directors, and former officers. The complaint also alleges that the defendants failed to protect Heritage from the substantial inherent risks of large-scale CRE lending. Furthermore, the FDIC alleges that the defendants tried to mask Heritage's mounting problems by making new CRE loans and making additional loan advances on existing troubled loans, allegedly often replenishing ''interest reserves,'' which the FDIC alleges allowed borrowers to pay interest with more borrowed funds.

FDIC as Receiver of 1st Centennial Bank vs. Appleton, et al.

On January 14, 2011, the FDIC brought its third D&O lawsuit arising out the failure of a recently failed depository institution when it filed suit in federal district court in California against 14 former directors and officers of 1st Centennial Bank, which was closed in January 2009. The FDIC alleges that the defendants failed to manage the bank and its CRE lending division in a prudent, safe, and reasonable manner. The complaint alleges, among other things, that the defendants recklessly implemented an unsustainable business model pursuing rapid asset growth concentrated in high-risk loans in CRE without having adequate credit administration and loan underwriting policies and practices to manage the risk. The FDIC stated that the failure of bank has caused an estimated $163 million loss to the Deposit Insurance Fund.

FDIC as Receiver of Integrity Bank of Alpharetta, GA v. Skow, et al.

On January 14, 2011, the FDIC brought its fourth D&O lawsuit, commencing an action in a federal district court in Georgia against eight former directors and/or officers of Integrity Bank, Alpharetta, Georgia seeking to recover over $70 million in losses allegedly suffered by the bank on 21 commercial and residential acquisition, development, and construction (''ADC'') loans approved by the defendants between February 4, 2005 and May 2, 2007. The eight director and officer defendants were also members of the bank's Director Loan Committee which was responsible for the bank's overall credit function. The complaint states that the defendants caused the bank to pursue an unsustainable growth strategy designed to exploit the then-expanding ''bubble'' in the residential and CRE market. The FDIC further alleges that, in order to facilitate rapid growth, the bank concentrated its lending in high-risk, speculative commercial and residential ADC loans in the Atlanta metropolitan area and some out-of-territory markets in South Carolina and Florida. The FDIC also alleges that the loans were further concentrated in a small number of preferred individual borrowers to an extent that exceeded the bank's own loan policy Georgia statutory lending limits.

FDIC as Receiver of Corn Belt Bank and Trust Company v. Stark, et al.

On March 1, 2011, the FDIC filed its fifth D&O lawsuit in federal district court in Illinois against four former bank directors and/or officers of Corn Belt Bank and Trust Company, Pittsfield, Illinois, seeking to recover losses of at least $10.4 million allegedly suffered by the bank. The FDIC was appointed as receiver of the bank on February 13, 2009, following the closure of the bank by the Illinois banking regulator. The FDIC alleges that the defendants failed to adequately inform themselves of the relevant risks and acted recklessly in approving one or more high-risk commercial loans as members of the bank's loan committee. In the complaint, which alleges acts of negligence and gross negligence, the FDIC states that the defendants' conduct was particularly egregious because they approved making one or more of the loans after bank examiners repeatedly warned the bank that it suffered from weak loan administration, and that it was facing risks posed by out of area lending, high loan-to-value loans, and excessive exposure to loan concentrations within its loan portfolio.

FDIC as Receiver of Washington Mutual v. Killinger, et al.

On March 16, 2011, the FDIC, as receiver of Washington Mutual Bank (''WaMu''), filed its sixth D&O lawsuit in federal court in Washington state, alleging that three of WaMu's former senior executive officers caused billions of dollars in losses to WaMu resulting from extreme and historically unprecedented risks with WaMu's held-for-investment home loans portfolio. The FDIC was appointed receiver of WaMu on September 25, 2008, following the closure of the thrift by the OTS. The complaint, which names WaMu's Chief Executive Officer, Chief Operating Officer, and its President of Home Loans as defendants, alleges that the defendants were chiefly responsible for WaMu's higher-risk home lending program, and that they allegedly focused on short-term gains to increase their own compensation, with reckless disregard for WaMu's longer term safety and soundness.

The complaint also names as defendants the wives of two of the defendants in the suit, in connection with certain alleged transfers of property. The complaint alleges that one of the defendants and his wife trans-

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ferred two residential properties to certain irrevocable qualified personal residence trusts (''QPRTs''), which the FDIC alleges constituted a fraudulent conveyance under Washington state law. In addition, the complaint alleges that one of the other defendants and his wife transferred their residence to a QPRT and also that the defendant transferred $1 million to his wife after the failure of WaMu. The FDIC again alleges that each of these transfers were fraudulent conveyances under Washington state law. The FDIC is also seeking an asset freeze order from the court restraining the two defendants and their wives from transferring their remaining assets in the amount of $10,000 or more without prior court approval during the pendency of the litigation.