

FDIC suing failed-bank leaders

Agency goes after officials it believes are culpable for dooming businesses

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Nearly 40 Illinois banks have failed since the start of 2009, but another financial tailspin might be in the offing for executives and directors whose institutions have collapsed in recent years.

The Federal Deposit Insurance Corp., the receiver for seized lenders, is in the early stages of suing those it believes are culpable for dooming some of the businesses. Nationally, the agency seeks to recover more than \$2 billion from former bank officials.

Illinois, among the states with the most failures, recently saw its first FDIC lawsuit. On Nov. 1, the FDIC sued 11 executives and directors of Heritage Community Bank. Charges include gross negligence.

The Glenwood-based bank was among the first local lenders to fail in the latest recession.

It's also unlikely to be the last over which the FDIC sues in this market. The agency brought claims

against directors and workers in a quarter of failures between 1985 and 1992.

"What the agency will do in 2010 and beyond remains to be seen," Vedder Price wrote in a recent report about bank failures and insiders. But "already, visible signs appear ominous," the law firm said, citing the first 2010-era lawsuit, filed in July, against operators of failed IndyMac Bank of California.

The FDIC is unlikely to sue over every failed bank, but executives are worried.

Ben Shapiro, former FDIC regional counsel and

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now a bank lawyer for Belongia Shapiro & Franklin, said last week that he was shocked by the Heritage suit because of the number of defendants as well as the way in which Heritage's downfall seems typical.

"They decided on a scorched-earth approach," Shapiro said of the naming of 11 defendants.

Like many other failures, Heritage went overboard on commercial real estate lending.

"They didn't have a great crystal ball, but who did?" said Shapiro, who's not involved in the case.

The FDIC seeks to recover losses of at least \$20 million that Heritage suffered because insiders "failed to properly manage" commercial real estate lending.

"It's making a lot of people very nervous," Shapiro said.

A 2008 enforcement action against Heritage was no more scathing than many of the dozens of oth-

ers filed against Illinois banks by regulators in hopes of preventing failure. For example, it didn't demand the ouster of any particular executive, as it did with, say, Oak Forest-based InBank before it fell.

The FDIC is also likely to try to settle with some bank insiders before getting to court.

In 2001, Chicago's Pritzker family struck a deal in which it and the co-owner of Superior Bank agreed to pay \$460 million without admitting wrongdoing in the lender's demise. The FDIC later sued the bank's accountant.

Before taking action, the FDIC considers such factors as whether the claim has merit and whether the litigation will be cost-effective given the bankers' personal assets and liability insurance.

FDIC action against bad actors should be welcomed, but a factor appears to be whether bank officials had directors and officers in-

surance, said Justin Barr, of turnaround consultant Loan Workout Advisers.

"This sends a chilling message to banking and insurance industries, and could dry up the availability of such insurance and could discourage the best and brightest minds from serving on community bank boards when their participation is needed most," Barr said. "This FDIC action will ruin lives unnecessarily and is, at best, short sighted."

Bill Brandt, whose Development Specialists has worked on restructuring involving financial services firms, said last week that the FDIC's goal is not only to cover its insurance fund losses, but also to warn other banks about troubling practices.

He said the FDIC usually pursues insiders under two circumstances: First, if a big dividend has been paid to investors in the 18 to 36 months before failure, and,

second, if the bank has made too many loans in one area, such as condominium construction.

The Heritage suit cites risky commercial real estate lending and \$11 million in "unjustified dividends."

Heritage defendants say the suit is "without merit" and note that the FDIC blames former officials "of a community bank for not anticipating the same market forces that also caught central bankers, national banks, economists, Wall Street firms and the regulators themselves by surprise."

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