FDIC demands $900 million in lawsuit against former WaMu executives

The lawsuit is the largest yet by the FDIC in its attempt to recoup funds from executives whose actions it alleges led to WaMu's failure.

By E. Scott Reckard, Los Angeles Times
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Seeking to recoup some losses from the biggest bank failure in U.S. history, federal regulators accused former Washington Mutual Inc. Chairman Kerry Killinger and two other former WaMu executives of gross negligence in a lawsuit demanding $900 million in damages.

The suit filed by the Federal Deposit Insurance Corp. is part of U.S. efforts to recover money from bank directors and officers whose actions — especially in approving questionable subprime mortgages and other risky loans — led to the failures of their institutions.

The booming housing industry began unwinding in 2007 as risky loans propping up trillions of dollars worth of securities sold worldwide began to sour. The resulting credit crisis staggered financial markets and led to the Great Recession.

Various federal regulators and state and local authorities have launched investigations and filed lawsuits in their efforts to assess blame and recover lost funds.

The FDIC already has authorized lawsuits against 158 former officials at failed banks, though it has filed just six actions so far. One suit, filed last July, seeks $300 million from four former executives at IndyMac Bank in Pasadena, another aggressive mortgage lender that collapsed two months before WaMu.

The WaMu lawsuit is by far the largest to come out of the agency.

The FDIC accused the three former executives of recklessly disregarding warnings from advisors and regulators about the dangers of subprime mortgages and other high-risk loans. WaMu, the nation's largest savings and loan before its 2008 collapse, had helped to popularize such lending during the housing boom in the first half of the decade.

The suit also said the bank paid the trio more than $95 million from 2005 to September 2008.

"They focused on short term gains to increase their own compensation, with reckless disregard for WaMu's longer term safety and soundness," according to the FDIC lawsuit, filed Wednesday in U.S. District Court in Seattle. "Their negligence, gross negligence and breaches of fiduciary duty caused WaMu to lose billions of dollars."

The suit also names as defendants WaMu's former president, Stephen J. Rotella, and a former loan executive, David C. Schneider. Killinger and Rotella issued strong denials of wrongdoing; Schneider declined to comment.

In a statement, Killinger called the suit baseless "political theater," saying he had diligently served the bank, its customers and shareholders.

He called WaMu's management "a model of corporate governance" and said all lending was reviewed by independent risk managers, board committees and outside auditors "and, perhaps most importantly," by bank regulators who were on the premises "24/7."

Killinger said regulators had applauded his raising of $10 billion in new capital as the mortgage meltdown took hold in late 2007 and early 2008, an effort he said had been turned into allegations of gross negligence "through the alchemy of Washington, D.C., politics."

Killinger joined the bank in 1988 and made $65.9 million in compensation during the nearly four years before the bank's failure, the FDIC said.

Rotella, WaMu's president and chief operating officer starting in 2005, earned $23.5 million in that time, and Schneider, the president of WaMu's home-loan operation starting in 2005, earned more than $5.9 million.

The wives of Killinger and Rotella, both of whom the FDIC alleged had property transferred to their names, also are defendants.

The suit asked the court to freeze the assets of the Killingers and the Rotellas. Los Angeles lawyer Jeffrey Tisdale, who defends former executives of failed banks, compared such requests to "the way the Department of Justice treats drug smugglers."

In statements released Thursday, Rotella said that the FDIC had refused to meet with him to discuss his efforts to address WaMu's problems and that he was "angered at this abuse of power." He said he had helped the bank to reduce "substantially" its mortgages and risks and to diversify operations.

"Furthrmore," he said, "it is patently unfair for the FDIC to expect an individual to have perfect foresight into a crisis that the FDIC itself did not see coming."

He said bank examiners rated WaMu "satisfactory" or better until months before the Office of Thrift Supervision closed WaMu and appointed the FDIC as receiver.

Schneider works for JPMorgan Chase & Co., which acquired WaMu from the FDIC after the failure. Chase declined to comment.

While defense attorneys complain that regulators are creating scapegoats, other critics fault the government for failing to file criminal charges against executives involved in the mortgage meltdown.

William Black, a University of Missouri professor and regulator during the 1980s savings and loan debacle, said that many criminal cases stemming from that crisis involved commercial loans that were more difficult to prove as fraudulent than the recent mortgages.

The latest batch consisted of many so-called liar's loans because they were based on what borrowers said they earned, not on documented income statements.

"How hard do you think it is to convince jurors that something known in the trade as liar's loans [and] produced 90% fraud rates were fraudulent?" Black said.

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