

The Subprime Mortgage Crisis – National City Bank’s Story

In mid- 2007, Cleveland, Ohio’s National City Bank (“National City”) was a leading regional bank and one of the ten largest banks in the United States in terms of deposits and mortgages. Its stock was trading comfortably in the mid-thirties and it was known to consistently provide a healthy dividend to its shareholders. At the time, National City was considered a stock to buy and hold as part of an investor’s “safe” investments. That all changed toward the end of 2007.

It became widely known that National City was yet another victim of the subprime mortgage crisis when in October, 2007, it was announced that loan related losses caused the bank’s third quarter 2007 net income to plunge 80% to \$106 million, or \$0.18 per share, from \$526 million or \$0.86 per share a year earlier. Losses forced the company to cut costs and ultimately lay off 2,500 employees.

With the announcement came an onslaught of class-action securities cases. The first subprime mortgage related lawsuits against National City were announced in January of 2008, with virtual simultaneous announcements coming from many high profile law firms. The lawsuits, all seeking class action status, were predominantly filed in the United States District Court for the Northern District of Ohio and purported to be brought on behalf of all persons who purchased the common stock of National City during the period between April 30, 2007 and January 2, 2008. The Complaints were filed against both National City and certain of its officers and directors.

The Complaints essentially allege that National City issued materially false and misleading statements regarding its financial results, as follows:

1. The subprime mortgages on National City’s books were a much bigger risk to the Company’s financial position than represented;
2. National City was failing to adequately reserve for mortgage-related exposure, causing its balance sheet and financial results to be artificially inflated; and
3. Defendants had no reasonable basis to make favorable predictions about the Company’s future dividend payments and future financial performance given the problems in the business.

The suits go on to allege that despite the October, 2007, reported losses, National City assured the market that its dividend would remain intact. Then, on January 2, 2008, National City announced a 49% reduction in its quarterly dividend to \$0.21 per share from \$0.41 per share. Also in January, 2008, National City disclosed that it was shutting down its wholesale mortgage division and eliminating 900 additional jobs. According to the Complaints, National City’s stock dropped from \$16.46 per share to close rate \$15.59 per share on the January news.

In addition to the securities suits, plaintiffs also filed shareholder derivative suits asserting that executives harmed the company through their actions. Class action suits were also filed on behalf of National City employees pursuant to ERISA, claiming that company executives violated their duties as pension plan fiduciaries by misleading employees as to the financial strength of the company.

With the passage of time, National City's stock price continued to decline and on April 1, 2008, the company announced that it was reviewing a range of strategic alternatives. At the time, it was widely reported that the company would be sold. There was much speculation as to possible purchasers.

On April 1, 2008, in the ERISA cases, the Court ordered that “[p]laintiffs will file a consolidated complaint not later than 45 days following the entry of an order granting plaintiffs' joint motion to consolidate cases and appointment of lead plaintiffs and interim co-lead and liaison counsel filed 2/29/08. Defendants to answer within 45 days following service of the consolidated complaint. If defendants file a motion directed at consolidated complaint, plaintiffs shall file opposition to the motion within 45 days following service of the motion. Defendants shall file reply to plaintiffs' opposition within 30 days following service. Plaintiffs have 90 days after the filing of pleading asserting the existence of a class to move for determination of whether the action should be maintained as a class action. Discovery shall be stayed pending the Court's decision regarding defendants' anticipated motion to dismiss the consolidated complaint. Plaintiffs shall move for a determination whether case is to be maintained as a class action within 120 days following defendants' answer to consolidated complaint. Parties shall file an agreed scheduling order within 30 days after defendants' answer.”

On April 4, 2008, Thomas P. Dinapoli, the Comptroller of the State of New York, as administrative head of the State of New York and Local Retirement Systems and as trustee of the New York State Common Retirement Fund, was chosen as the lead plaintiff in the securities case. The Court also designated Kirby, McInerney, LLP and Van Deusen & Wagner, LLC as lead and liaison counsel for lead plaintiff. On April 14, 2008, the Court signed a Stipulation and Proposed Order applicable to the Securities Case which states:

1. Lead Plaintiff shall file a Consolidated Class Action Complaint (the “Consolidated Complaint”) within sixty (60) days of entry of this order.
2. Defendants shall have sixty (60) days in which to answer or otherwise respond to the Consolidated Complaint.
3. If Defendants move with respect to the Consolidated Complaint, Lead Plaintiff shall file its opposition to Defendants' motion within sixty (60) days.
4. Defendants shall file their reply within thirty (30) days of Lead Plaintiff's opposition.

On April 8, 2008, the multiple suits filed against National City were consolidated under *National City Corporation Securities, Derivative & ERISA Litigation*, Case No. 1:2008cv07000,

before Judge Patricia A. Gaughan of the United States District Court for the Northern District of Ohio. The Order of Consolidation notes “[t]he cases fall under three general types of categories: cases filed under ERISA (“the ERISA Cases”), derivative shareholder actions (“the Derivative Cases”) and a direct shareholder class action lawsuit (“the Securities Case”).” The Order of Consolidation goes on to state in pertinent part:

1. All ERISA Cases, Derivative Cases and the Securities Case will be grouped together for pretrial purposes only. All pretrial filings in these matters shall be filed under a master docket, which will be captioned as follows: In re National City Corporation Securities, Derivative & ERISA Litigation, Master File No. 08 CV 7000, Judge Patricia A. Gaughan.
2. For pretrial purposes, filings must be filed only in the master docket.
3. All discovery taken will apply to any subsequently filed and to all consolidated actions, and the parties will not be required to repeat discovery already undertaken.
4. The selection of lead plaintiff and lead liaison counsel will be addressed by separate order of the Court.
5. Upon the completion of the pretrial phase of this litigation, parties will no longer submit filings under the Master Docket. Rather, the ERISA Cases will file solely in Case No. 08 CV 61, the Derivative Cases will file solely in Case No. 08 CV 163 and the Securities Case will file solely in Case No. 08 CV 209.

On Monday, April 21, 2008, National City announced it had secured seven billion dollars of equity capital to save the bank following its steep mortgage losses. The Company announced that it would obtain \$985,000,000 from New York based Corsair Capital, LLC. The rest would come from other investors, including current institutional shareholders. National City also reported that it was issuing 126.2 million shares of common stock at a purchase price of \$5 per share.

In the same release, National City announced that it was cutting its common dividend to \$0.01 per share from the previous \$0.21 per share. The company’s stock nose-dived on the news, ultimately bottoming out below \$5 per share, a loss of more than 80% of share value in less than a year. Despite a seven billion dollar capital infusion, National City’s troubles are far from over.

On May 12, 2008, the Court granted a motion to appoint James Elsinghorst and Barbara Grosick as lead plaintiffs on behalf of a proposed class of participants and beneficiaries in the consolidated ERISA Cases. In the same order, Stull, Stull & Brody and Schiffrin, Barroway Topaz & Kessler, LLP were appointed co-lead counsel for the ERISA Cases pursuant to Fed. R. Civ. P. 23(g). Lastly, Goldman, Scarlato & Karon, P.C. was appointed as interim liaison counsel for the proposed class.

Also on May 12, 2008, Judge Gaughan appointed Richard Lerach and Charles Greve as co-lead plaintiffs in the Derivative Cases. In the same Order, the Court appointed Robbins, Umeda & Fink, LLP and Landskroner, Grieco, Madden, Ltd. as co-lead counsel for the consolidated Derivative Cases.

Having appointed lead plaintiffs and counsel for all three categories of litigation, the Court further ordered that only lead/liaison counsel appear at all scheduled court appearances and, absent leave of court, only lead/liaison counsel shall be permitted to file in the Master Docket.

In a press release dated June 10, 2008, National City announced that subprime related issues continue outside the courtroom as well. In the press release, National City announced that it entered into separate Memoranda of Understanding with the Office of the Comptroller of the Currency and the Federal Reserve Bank of Cleveland on May 5 and April 29, 2008, respectively, which address the issues of capital management, risk management, asset quality and liquidity management. The release indicates, though, that the Memoranda relate to issues which have already been publicly reported.

On June 13, 2008, the lead plaintiff in the Securities Case filed its Amended Class Action Complaint for Violations of the Federal Securities Laws. The Complaint is two hundred and forty three pages long and is accompanied by a five page table of contents. In the Complaint's 507 paragraphs, and multiple subparagraphs, the plaintiff alleges misrepresentations from April, 2007, through until April of 2008, when "the Truth Is Revealed." The Complaint focuses on National City's residential real estate loans and specifically the company's Construction Loans, NHE New Production Loans and First Franklin loans. Paragraph five of the Complaint states:

Essentially, with respect to each of the above-mentioned groups of loans, plaintiffs allege the defendants misrepresented (1) the basic nature and quality of the loans, (2) the performance of the loans, and (3) the credit risk to the Company of those loans, including the loan loss reserves maintained by defendants in amounts purportedly adequate to absorb those credit risks.

Paragraph six of the Complaint states: "Put bluntly, the Company had approximately \$10 billion more of subprime loans than defendants represented."

While the class action cases remain and will continue to plague National City for some time, the company recently received some good news. On June 12, 2008, the company's shares jumped 9.4% on the recommendation of analysts at Sandler, O'Neill to move the stock to "buy" from "hold" status, opining that the company had ample capital to weather even the most punishing credit cycle.