Securities Regulation Daily Wrap Up, TOP STORY—BofA's $17 billion civil pact over Great Recession-era loans biggest ever for one company, (Aug. 21, 2014)

Click to open document in a browser

By Mark S. Nelson, J.D.

A long-rumored civil settlement between Bank of America Corporation (BofA) and federal and state financial regulators including the Department of Justice (DOJ) and the SEC is the largest of its kind in U.S. history. The nearly $16.65 billion global settlement requires BofA to acknowledge its role in the origination and packaging of toxic home loans and ends many regulators' claims against BofA and two firms it acquired during the 2008 financial crisis, Countrywide and Merrill Lynch. The deal also provides relief to consumers whose home loans were swept up in BofA's mortgage-backed-securities business.

Attorney General Eric H. Holder, Jr. said the settlement with BofA was part of the DOJ's ongoing effort to target banks' actions during the 2008 financial crisis. "We are here to announce a historic step forward in our ongoing effort to protect the American people from financial fraud — and to hold accountable those whose actions threatened the integrity of our financial markets and undermined the stability of our economy."

Attorney General Holder added that the size of the deal sends a message that BofA's payments are not merely a "cost of doing business" and that today's deal was not fated to occur. He also said the deal will not bar criminal charges against BofA or its employees.

BofA said in a statement that many of the claims resolved by the global settlement relate to activities that occurred before BofA acquired Countrywide and Merrill Lynch. BofA CEO Brian Moynihan said, "We believe this settlement, which resolves significant remaining mortgage-related exposures, is in the best interests of our shareholders, and allows us to continue to focus on the future."

BofA said the settlement's varied tax treatment may hit its Q3 2014 pre-tax earnings by up to $5.3 billion (an estimated after-tax impact of $0.43 per share). Earlier this month, BofA announced that it would hike its dividend next month. The bank's capital actions followed the Fed's indication that it did not object to them in light of BofA's latest Comprehensive Capital Analysis and Review.

SEC reporting violations. The settlement also ends two SEC actions against BofA in exchange for BofA's paying more than $245 million. In an administrative proceeding filed today, the SEC required BofA to admit key facts and to acknowledge that its conduct ran afoul of the federal securities laws. BofA also will pay a civil money penalty of $20 million to resolve the SEC's latest charges (*In re Bank of America Corporation*, August 21, 2014).

"Requiring an admission of wrongdoing as part of Bank of America's agreement to resolve the SEC charges filed today provides an additional level of accountability for its violation of the federal securities laws," said Rhea Kemble Dignam, director of the SEC's Atlanta regional office.

In the administrative case, the SEC alleged that BofA violated the Exchange Act by failing to disclose known uncertainties about Federal National Mortgage Association's (Fannie Mae's) post-receivership repurchase practices and the future volume of monoline insurers' repurchase claims. The SEC said BofA should have included this information in the Management's Discussion and Analysis and results of operations sections in its Forms 10-Q for mid-2009.

The SEC cited BofA's representations and warranties for the residential mortgage-backed securities (RMBS) as an example. During 2004 to 2008, BofA sold $2.1 trillion in RMBS securitizations and whole loans to investors. But later events, including Fannie Mae's government-mandated receivership, could have hiked the cost of related mortgage loan repurchase claims. According to the SEC, BofA had information that Fannie Mae's post-receivership repurchase claims policy was more aggressive and could lead to more "contested" claims.

Of the $160 billion in RMBS BofA sold to private-label investors (other financial institutions), nearly 17 percent of the loans received credit enhancements or guarantees by monoline insurers. The SEC said monoline insurers contested more claims as the financial crisis progressed.

The SEC and BofA also resolved charges the agency filed against the bank in August of 2013. There, the SEC alleged that BofA and its subsidiaries lured investors who wanted a safer mortgage investment option into a deal known as "BOAMS 2008-A" that was to consist of less risky prime mortgage loans. But the SEC said this investment actually contained many riskier loans that were originated by mortgage brokers unaffiliated with BofA (the "wholesale channel").

According to the SEC, BofA violated provisions of the Securities Act in attempting to sell the BOAMS 2008-A offering. BofA allegedly knew the wholesale loans upped the risk profile of the investment, failed to disclose the concentration of these loans in its SEC filings, and later closed the wholesale channel. An ex-BofA CEO called the wholesale loans "toxic waste."

Today's settlement of the 2013 case imposes still more penalties on BofA. The bank must pay disgorgement and a civil penalty of $109.22 million each. The SEC also required BofA to pay prejudgment interest of $6.62 million, bringing the total 2013 settlement amount to over $225 million.

FDIC fraud claims. BofA also agreed today to settle fraud charges brought by the Federal Deposit Insurance Corporation (FDIC) alleging that offering documents for 155 RMBS transactions with 26 banks now in FDIC receivership contained misrepresentations about the nature of the investments. The settlement will net more than $1.03 billion for the FDIC, which it said will be distributed to the receiverships for the failed banks.

The FDIC also said today's deal will resolve other pending suits between the agency and BofA, including a breach of contract claim by the FDIC against BofA. The bank also agreed to settle tort, Administrative Procedure Act, and Freedom of Information Act claims brought by it (or on its behalf) against the FDIC.

Global settlement. The global $16.65 billion deal announced this morning resolves claims brought against BofA by the DOJ and the attorneys general of six states, in addition to BofA's settlements with the SEC and the FDIC. BofA agreed to pay a $5 billion penalty to settle the DOJ's claims under the Financial Institutions, Reform, Recovery and Enforcement Act. BofA will pay $1.8 billion to settle other federal fraud claims related to its origination and sale of mortgages.

Consumers also have a stake in the global settlement. BofA agreed to pay $7 billion for loan modifications to get some home mortgages above water and to make new loans to credit-worthy borrowers. The remainder of these funds will be used for community reinvestment type activities to aid the ongoing recovery from the 2008 financial crisis and to promote affordable housing.

BofA pledged another $490 million into a tax relief fund to help offset tax liabilities borrowers may incur if they partake of the consumer relief offered by the DOJ deal. Attorney General Holder said the fund is needed because Congress did not extend a law that would have excluded payments to consumers from their taxable income. The Attorney General asked Congress to extend key features of the Mortgage Forgiveness Debt Relief Act of 2007 because the current lack of consumer tax relief also may impact prior DOJ settlements with JPMorgan Chase and Citigroup.

New York will get $300 million from the settlement. "This historic settlement builds upon our work bringing relief to families around the country and across New York who were hurt by the housing crisis, and is exactly what our working group was created to do," said New York Attorney General Eric T. Schneiderman. "The frauds detailed in Bank of America's statement of facts harmed countless of New York homeowners and investors. Today's result is a major victory in the fight to hold those who caused the financial crisis accountable," he added.

"Bank of America profited by misleading investors about the risky nature of the mortgage-backed securities it sold. This settlement makes our pension funds whole for the financial losses caused by these misrepresentations and brings help to hard-pressed homeowners and communities in California," said Kamala D. Harris, the state's attorney general. Like New York, California will get $300 million.

Illinois Attorney General Lisa Madigan said the global settlement marks the fourth time Illinois has pursued BofA over financial crisis-related claims. “Bank of America, and in particular Countrywide, were major players in virtually every aspect of the market that caused the crisis, from shoddy loan originations and discriminatory lending to African Americans and Latinos to fraudulent marketing of mortgage-backed securities,” said Madigan. Illinois will get $200 million under today’s deal.

The attorneys general of Maryland ($75 million), Delaware ($45 million), and Kentucky ($23 million) also praised the settlement. Maryland Attorney General Douglas F. Gansler echoed Attorney General Holder’s observation that the global settlement does not release individuals from possible civil claims, nor does it release entities or individuals from future criminal liability.

The Release is No. 34-72888.

Companies: Bank of America Corporation; Countrywide; Merrill Lynch; JP Morgan Chase; Citigroup

MainStory: TopStory Enforcement FormsFilings FraudManipulation PublicCompanyReportingDisclosure