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BofA pays $2.4 billion to settle claims over Merrill

Martha Graybow, Rick Rothacker ⁝⁝ 9/28/2012

By Martha Graybow, Rick Rothacker

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(Reuters) - Bank of America Corp agreed on Friday to pay $2.43 billion to settle claims it hid crucial information from shareholders when it bought investment bank Merrill Lynch & Co at the height of the financial crisis.

A Bank of America Merrill Lynch sign is seen on a building that houses its offices in Singapore May 17, 2012. REUTERS/Tim Chong

The settlement, among the biggest of its kind to stem from the 2008 meltdown, underscores how Bank of America is still suffering from decisions it made during the crisis, even as competitors are moving on.

The second largest U.S. bank likely lost money in the third quarter in large part because of the agreement, while other major banks, including JPMorgan Chase & Co and Wells Fargo & Co are expected to earn billions of dollars each.

As Lehman Brothers failed in September 2008, Bank of America agreed to buy Merrill Lynch. But in the weeks after that agreement, the bank tried unsuccessfully to scrap the deal. Merrill Lynch generated more than $15 billion of losses and its executives agreed to award employees up to $5.8 billion of bonuses.

Bank of America's shareholders voted to approve the deal in December 2008. After the merger closed, Bank of America shares fell sharply, and investors sued, saying Merrill's losses and bonuses should have been disclosed before the vote.

Bank of America denied the lawsuit's allegations, but CEO Brian Moynihan said the bank agreed to settle to remove uncertainty and put the case behind it.

The Merrill Lynch deal, as well as the bank's 2008 purchase of subprime lender Countrywide Financial, have ended up costing Bank of America billions, with the bank's mortgage business alone losing more than $35 billion since the Countrywide deal.

But the Merrill Lynch acquisition has also given much needed revenue to Bank of America. While the bank does not break out its results from Merrill Lynch, its wealth management and investment banking units, which owe much of their business to Merrill, generated nearly $160 billion of revenue from 2009 through June, or 43 percent of the bank's overall revenue.

Friday's settlement, which requires court approval, would resolve a case set for an October 22 trial in U.S. District Court in Manhattan. Investors sued the company and executives including former Chief Executive Ken Lewis, but Bank of America said it was footing the bill for the settlement.

At a brief hearing before Judge Kevin Castel on Friday afternoon, the judge told lawyers, "This is, needless to say, a good development," referring to the settlement. Few expect the settlement to face the obstacles that Bank of America experienced in 2009 when settling with the Securities and Exchange Commission over this same acquisition. A judge rejected the bank's initial settlement and forced both parties to renegotiate it.

LONG-SOUGHT DEAL

In September 2008, Bank of America's Lewis told his shareholders that buying Merrill Lynch was a real opportunity. The investment bank had the biggest retail brokerage on the Street, which gave Bank of America a new channel for selling products like credit cards.

As the deal started to look bad toward the end of 2008, Lewis tried to back out of it. But then-Treasury Secretary Henry Paulson pressured him to go through with the transaction. In January 2009, when Bank of America closed on its Merrill Lynch purchase, it received a $20 billion government bailout to shore up its balance sheet.

Bank of America has since repaid the money. Lewis retired at the end of 2009.

The deal helped the financial system but hurt Bank of America's shareholders, said Gary Townsend, chief executive of Hill-Townsend Capital in Chevy Chase, Maryland. Bank of America shares have slid more than two-thirds since the Merrill deal was announced in September 2008.

"It's good to get a bad tooth removed. But the question is, 'How expensive was Ken's mistake back in 2008?,'" Townsend said.

Lewis, when contacted by Reuters, declined to comment on the settlement.

The Merrill deal was valued at $50 billion when announced, but the final price was around $29.1 billion as Bank of America's shares fell.

Bank of America's acquisitions have continued to bring it pain. Since the financial crisis, the bank has agreed to pay more than $16 billion in 12 settlements with mortgage investors and other accords linked to takeovers, counting an $8.5 billion pact that still needs court approval.

On top of that $16 billion, Bank of America is on the hook for $11.8 billion in payments, mortgage modifications and loan refinancings as part of a $25 billion settlement this year over allegedly faulty handling of foreclosures.

EXPECTED LOSS

The bank expects to incur total litigation expenses of about $1.6 billion in the third quarter. It said that expense, a U.K. tax charge and a charge related to improvements in the company's credit spreads would hit quarterly results by about 28 cents per share. That would likely trigger a loss for the period. Analysts had expected profit of 14 cents per share when the bank releases results on October 17, according to Thomson Reuters I/B/E/S.

Lead plaintiffs in the lawsuit included the State Teachers Retirement System of Ohio, the Ohio Public Employees Retirement System and the Teacher Retirement System of Texas. The case was originally filed in 2009 by former Ohio Attorney General Richard Cordray, now director of the U.S. Consumer Financial Protection Bureau.

Four to five million shareholders could be eligible to share in the settlement, said Dan Tierney, spokesman for Ohio Attorney General Mike DeWine. Payouts will depend on the number of shares owned, he said.

Bank of America shares slipped 9 cents to $8.88 on the New York Stock Exchange in afternoon trading.

Prior to this accord, the largest crisis-era investor class action settlement involved allegations Wachovia, now part of Wells Fargo & Co, misled investors about the quality of loans sold before the financial downturn, according to NERA Economic Consulting.

Wells Fargo agreed last year to pay $590 million to resolve that lawsuit, on top of $37 million that auditor KPMG LLP agreed to pay.

Overall, the largest securities fraud settlements in U.S. history include the $7.2 billion agreement with investors stemming from the collapse of Enron; the $6.2 billion WorldCom settlement; and the $3.2 billion agreement over the accounting scandal at Tyco International, according to Stanford Law School's Securities Class Action Clearinghouse.

Under the Bank of America settlement, the bank will also make changes to its corporate governance through January 1, 2015. Some of the changes already were part of a February 2010 settlement with the U.S.

Securities and Exchange Commission, including provisions on independence of the board compensation committee and an annual shareholder vote on executive pay.

The plaintiffs' law firms leading the case are expected to apply for $150 million in fees, said Tierney, the Ohio attorney general's spokesman. The law firms include Bernstein Litowitz Berger & Grossmann; Kaplan Fox and Kessler Topaz Meltzer & Check. The fee, which would be subject to court approval, works out to 6 percent of the settlement fund.

Additional reporting by Grant McCool and Nate Raymond in New York, Tom Hals in Wilmington, Delaware and Tanya Agrawal in Bangalore; Editing by Supriya Kurane, Jeffrey Benkoe and David Gregorio