Record Bank of America Settlement Latest in Government Crusade

Bank Agrees to Pay $16.65 Billion in Cash and Consumer Aid

By Christina Rexrode And Andrew Grossman

Bank of America Corp.'s financial-crisis hangover may finally be fading.

On Thursday, the bank agreed to pay $16.65 billion to settle the government's accusations it sold flawed mortgage securities in the run up to the 2008 crisis, the largest settlement ever reached between the U.S. and a single company.

For the U.S. government, the deal is a chance to put an exclamation point on a string of crisis-era enforcement actions and lawsuits that have cost big U.S. banks tens of billions of dollars. The Charlotte, N.C. lender will have to pay $9.65 billion in cash to the Justice Department, six states and other government agencies. The bank also will provide $7 billion in consumer aid by modifying mortgages for borrowers who owe more than their homes are worth, demolishing derelict properties or other relief.
For Bank of America, the settlement is a bitter coda to its decision in 2008 to buy two companies, Countrywide Financial Corp. and Merrill Lynch & Co., as they teetered during the housing crisis. Bank of America Chief Executive Officer Brian Moynihan, who has spent his 4 1/2 years as CEO wading through litigation, has told investors this is the last of the big crisis-era problems. His next challenge: proving the bank has the mettle to make money in an era of weak loan demand and low interest rates.

In a statement, Mr. Moynihan said the settlement "is in the best interests of our shareholders, and allows us to continue to focus on the future." Giant legal charges have depressed the bank's earnings for years, frustrating some investors. The bank said the settlement will cut third-quarter pretax earnings by $5.3 billion, or 43 cents a share after tax.

Shares in the company rocketed more than 4%, to close at $16.16, as investors welcomed the resolution of a long-running legal headache.

Bank of America agreed to pay a settlement of $16.65 billion over its mortgage lending, the largest ever between the U.S. and a single company. WSJ's Aaron Lucchetti joins MoneyBeat with the details.

The Justice Department's case against Bank of America provides perhaps the clearest window yet into the behavior that fueled the 2008 financial crisis: Lenders knowingly providing credit to borrowers who couldn't afford the loans and selling those mortgages
to unwitting investors. Borrowers ultimately defaulted, sending them into foreclosure and saddling investors with hefty losses.

Many of the mortgage securities in question were made by Countrywide and Merrill Lynch. But the government found problems with Bank of America's own mortgage securities as well, including efforts to circumvent underwriting standards by changing applicants' financial information.

In at least one instance, an underwriter at Bank of America made more than 40 attempts to win an "accept" rating from an internal Countrywide system—known as CLUES—that would allow Bank of America to make a loan, according to a statement of facts signed by the U.S. and Bank of America.

"One underwriter characterized what she was doing as trying to 'trick' the CLUES system into giving an 'accept' rating," according to the document.

The ramifications of originating weak loans was predicted by former Countrywide CEO Angelo Mozilo, who warned in an Aug. 1, 2005 email to other executives that real-estate developers were anticipating a condo-market collapse in areas like South Florida and Las Vegas, and said the firm should avoid putting certain loans on its own balance sheet. Mr. Mozilo was worried the large increase in monthly payments required by many of the Countrywide-issued mortgages ultimately would cause borrowers to default.

Attorney General Eric Holder announces the settlement with Bank of America Thursday. European Pressphoto Agency

"The simple reason is that when the loan resets in five years there will be enormous payment shock and the borrower is not sufficiently sophisticated to truly understand the consequences then the bank will be dealing with foreclosure in potentially a deflated real estate market. This would be both a financial and reputational catastrophe," Mr. Mozilo wrote, according to Justice Department documents.

Prosecutors in Los Angeles are preparing to file civil charges against Mr. Mozilo and other former Countrywide executives, according to a person familiar with the situation. Mr. Mozilo's lawyer, David Siegel, said, "There is no sound or fair basis, in law or in fact, to pursue any claims against Angelo Mozilo."

Countrywide, in particular, has morphed from trophy to albatross for Bank of America. The bank had a history of gobbling up competitors when it bought Countrywide in 2008 and the deal launched it to the top of the mortgage world.
The purchase, though, has brought legal headaches and regulatory scrutiny, including a multistate settlement over alleged predatory lending practices just months after Bank of America bought the lender. The bank's mortgage unit hasn't turned a profit in years.

The settlement comes on the heels of similar, but smaller, deals over precrisis mortgage-related conduct with Citigroup Inc. C +2.55% for $7 billion and J.P. Morgan Chase JPM +1.49% & Co for $13 billion. The Justice Department is expected to turn its attention next to other banks accused of selling flawed mortgage securities, including Goldman Sachs Group Inc. GS +0.64% and Wells Fargo& Co., according to people familiar with the matter. Those cases are expected to be smaller than the previous three settlements.

"Bank of America has acknowledged that, in the years leading up to the financial crisis that devastated our economy in 2008, it, Merrill Lynch and Countrywide sold billions of dollars of RMBS backed by toxic loans whose quality and level of risk they knowingly misrepresented to investors and the U.S. government," Attorney General Eric Holder said at a news conference, referring to residential mortgage-backed securities.

The settlement resolves claims by various governments and agencies and releases the bank from numerous matters related to mortgage securities, collateralized debt obligations and mortgage origination. It doesn't release the bank from criminal liability and the Justice Department reserved the right to file both criminal and civil charges against individuals.

The settlement caps months of tense negotiations, during which the bank's lawyers argued repeatedly—and unsuccessfully—the firm was being unfairly punished for misdeeds of Countrywide and Merrill, according to people familiar with the talks. Prosecutors were similarly unmoved by the bank's argument it already had paid mightily for crisis-era sins, shelling out some $60 billion before Thursday's settlement.

During negotiations, Mr. Moynihan enlisted two trusted lieutenants—General Counsel Gary Lynch and chief strategy and marketing officer Anne Finucane—to call board members and keep them informed.

For weeks, the bank refused to up its offer beyond $13 billion, wary of comparisons to J.P. Morgan's $13 billion settlement. The bank's resistance weakened one day in late July, when a New York judge ruled that the bank would have to pay more than $1 billion over claims related to an old Countrywide loan program, and when Mr. Holder told Mr. Moynihan that the government stood ready to file a lawsuit prepared by the U.S. Attorney's Office of New Jersey.

After that phone call with Mr. Holder, Mr. Moynihan asked for time to call a few other decision makers, including board chairman Chad Holliday. The reaction from others at the bank was that a $17 billion deal was expensive—but worthwhile if it could resolve a big chunk of its problems.

The statement of facts, more detailed than those released in the J.P. Morgan and Citigroup settlements, paint an unflattering picture of Countrywide and Merrill, as well as Bank of America.

The findings against Countrywide are particularly damning. The lender, an advocate of home ownership but also a pioneer of subprime and other risky loans, was itching to
expand market share in the early 2000s. When potential customers with lousy credit scores applied for mortgages, Countrywide employees sometimes shuffled them to "shadow" underwriting guidelines. The firm often didn't verify whether borrowers were being truthful about their income, and offered loans allowing borrowers to pay less than just the interest owed —meaning the amount borrowers owed grew over time instead of shrinking.

When Countrywide's executives were told that some borrowers appeared to be overstating their income, the chief risk officer shrugged off the concerns, writing in an email, "Many (most?) borrowers seek to report as little income as possible on their tax return."

"We need to be careful painting all of this as a 'misrep,'" the chief risk officer wrote. "Although that is obviously the case in some (perhaps many) instances, it won't be the case in all cases."

The Justice Department also found that Merrill Lynch ignored warnings from an outside vendor who noted the high number of "EV3" loans in certain subprime mortgage securities. The EV3 label was given to particularly questionable mortgages, such as those made to borrowers who had recently declared bankruptcy. Merrill traders, though, often overruled those labels.

In an internal email about a particular pool of loans, a consultant in Merrill Lynch's due-diligence department wrote: "[h]ow much time do you want me to spend looking at these [loans] if [the co-head of Merrill Lynch's RMBS business] is going to keep them regardless of issues?...Makes you wonder why we have due diligence performed other than making sure the loan closed."

Market Talk

**Whistleblowers' Part in BofA Settlement** Whistleblowers may have played a role in one of the investigations that led to Bank of America's giant $16.65 billion settlement. The Justice Department says one strand of its case stemmed from government probes into the origination and sale of "defective" mortgages by BofA and its acquisition of Countrywide -- and that three sealed lawsuits filed by whistleblowers over those practices are being resolved as part of the settlement. No immediate word from Justice Department about the exact role of whistleblowers or whether they'll get a cut of the $1 billion BofA is paying over that portion of the overall settlement. (michael.rapoport@wsj.com)

**RMBS Investors Expect Losses from Settlement** Investors in residential mortgage-backed securities should brace for more principal writedowns on their securities when BofA starts meeting its consumer relief obligations under the $16.65 billion settlement with the Justice Department, said two big bondholders. Investors have long complained that banks are modifying loans they do not own, pushing losses to private investors but still taking credit under terms of settlements. One group, the Association of Mortgage Investors, has been trying to curb the right for such modifications in settlements but was denied a seat at the BofA talks by the DOJ, according to Debtwire. (albert.yoon@wsj.com)
Market Talk is a stream of real-time news and market analysis that's available on Dow Jones Newswires

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