

## **Bank of America's Shareholders (and All Wall Street Shareholders) Should Reject Bonus Plans** (Update 1)

TSF – ([click here to view at the Huffington Post](#)) – January 12, 2010

By Janet Tavakoli

In July 2009, New York Attorney General Andrew Cuomo [reported](#) that, among other things, the compensation structures at most banks were “a major impetus for the subprime fiasco.”<sup>1</sup>

Shareholders fed up with the fact that key contributors to the global credit crisis plan to pay billions of dollars worth of cash and stock in bonuses to employees might consider following Goldman's suit. Goldman Sachs's shareholders [brought separate actions against the Board of Directors](#) for alleged breach of fiduciary duties in approving billions of dollars in bonuses.

Bank of America and its acquisitions, Countrywide and Merrill Lynch, were neck-deep in the subprime crisis. In July 2008, Bank of America acquired Countrywide, which made \$97 billion in subprime or high interest loans during the peak years of 2005 through 2007.<sup>2</sup> On October 6, 2008 (three days after TARP was approved), Bank of America agreed to settle a multi-state predatory lending lawsuit against Countrywide for \$8.7 billion. Bank of America received its first \$25 billion TARP injection around three weeks later.

Bank of America proposes to pay billions of dollars worth of cash and stock bonuses to its Merrill Lynch employees. Merrill Lynch claims that the fact that it lost tens of billions of dollars on so-called super senior ‘investments’ during the crisis is proof it innocently sold risky investments to others. Don't believe it. Here's what happened. Merrill was involved with a lot of subprime lending and packaging and knew or should have known exactly what it was doing. What is more, Merrill had other pockets of risk unrelated to subprime.

For example, in December 2006, Ownit, a California-based mortgage lender partly owned by Merrill, declared bankruptcy. Its CEO, William Dallas, stated [he was paid more to originate no-income-verification loans](#) than for loans with full documentation. Michael Blum, then Merrill Lynch's head of global asset-backed finance, sat on Ownit's board. (Blum left Merrill in mid 2008 after the securitization was cut back.) When Ownit declared bankruptcy—instead of demanding a fraud audit—Blum faxed in his resignation.

After the bankruptcy, Merrill continued packaging Ownit's loans. Following a multi-year pattern, Merrill disguised the risk. Merrill packaged Ownit's risky loans in 2007, [and failed to disclose](#) that it was Ownit's largest creditor. Within a year, the so-called “AAA” rated tranche was downgraded to a junk rating of B, meaning you are likely to lose your

shirt. (A mutual fund was stuck with it.) This meant that “investment grade” tranches below the “AAA” were worthless or nearly worthless, because those investors agreed to take losses before the “AAA” investors.

*Losses were not simply due to fickle market prices. There was permanent value destruction.*

Merrill Lynch further disguised risk by repackaging phony “investment grade” tranches into new investments called CDOs and CDO-squared. Credit derivatives amplified the problem, because one could sell value-destroying investments more than once. This was only obvious to professionals, because some mortgages took a couple of years for payments to reset. By 2007, things were so bad that many loans were total shams and began defaulting almost immediately. This is the classic end of a Ponzi scheme.

Merrill Lynch did not sell tens of billions of uninsured so-called super-safe “super senior,” CDOs, because if it had, in-the-know market players would have discounted them.<sup>3</sup> Merrill’s employees wanted to continue to earn high bonuses, so they did not sell them, they did not record losses, and they temporarily got away with this fiction. Merrill’s accountants—like all of Wall Street’s accounting firms—failed in their jobs.

At the beginning of 2007, the problem was obvious to many alert non-professionals, but the SEC still let Merrill (and other Wall Street firms) get away with it. That year, Merrill Lynch issued 30 CDOs amounting to \$32 billion. Within a year, every single CDO had its “AAA” tranches downgraded to junk by one or more rating agencies. (Click [here](#) for my June 2008 commentary. The third page shows each 2007 CDO, the CDO “manager” involved, and the CDOs’ status at the time.)

By the second quarter of 2007, Merrill’s executives still told shareholders things were rosy. Yet Bear Stearns’s hedge fund creditors heavily discounted similar investments and put low prices on many of them. Credit derivatives benchmarks began a death spiral. Merrill Lynch failed to take billions of dollars of losses for the second quarter of 2007, despite publicly available information that belied its accounting reports.

Bank of America struck a deal to acquire Merrill Lynch in September 2008. In January 2009, one month after the shareholder vote on the merger, BofA revealed that Merrill reported more than \$15 billion in losses for the fourth quarter of 2008. Even then BofA did not come clean about the exact timing of the losses. BofA claimed the losses occurred in December. I publicly refuted the claim and said most of the losses had probably occurred in November due to trading activities *unrelated* to subprime or CDOs (Click [here](#) for more).

In this January 23, 2009 [CNBC video](#), I refuted BofA’s timing claim at 04:28:

Bank of America [kept shareholders in the dark](#) and took another \$20 billion in TARP money. The Slumbering Esquires Club (SEC) may just now file [a new complaint](#) to add the charge that Merrill failed to disclose the enormous material losses before the December 2008 shareholder vote.

Bank of America continues to receive massive subsidies from the U.S. taxpayer without which its level of earnings would not be possible. BofA took \$45 billion in TARP money (since repaid), has guarantees of \$118 billion against bad assets, and continues to receive massive amounts of taxpayer financing subsidies in various forms.

Why should Bank of America—or any other firm involved with the debacle—hand out billions of dollars worth of cash and stock to employees while pretending its business model and incentives aren't fatally flawed?

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1 Bank of America, Merrill Lynch (now part of Bank of America), Washington Mutual (now part of JPMorgan Chase), Wells Fargo, General Electric, JPMorgan Chase, Citigroup, Bear Stearns (now part of JPMorgan Chase), AIG, and Wachovia (now part of Wells Fargo) were participants or are now current owners of the [top 20 subprime \(or high interest loan\) lenders](#) during the period of the worst abuses from 2005 through 2007. In addition, these financial institutions, along with Goldman Sachs and Morgan Stanley, contributed funding through credit lines or sales without which the lending would not have been possible. (Click [here](#) for a list of subprime mortgage backed securities underwriters.)

2 Countrywide was renamed Bank of America Home Loans in February 2009. Separately, BofA bought Merrill Lynch, which bought First Franklin from Nat City in September 2006. First Franklin was one of the top four subprime lenders with more than \$68 billion in loans from 2005 to the end of 2007. The operation was closed in March 2008.

3 Merrill Lynch could not find enough demand from bond insurers to disguise its risk. AIG stopped insuring Merrill's CDOs before the end of 2006. Merrill insured other CDOs with other bond insurers: ACA (now bankrupt) and municipal bond insurer MBIA, which was since downgraded from AAA to junk.

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