Bank of America's woes prompt dire predictions
by Nicole Duran And Ira Teinowitz
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Bank of America Corp.'s latest litigation woes, which led to a drubbing of its stock this week, has led some analysts to predict the nation's largest retail bank will become the first test case for unwinding a "too big to fail" institution in accordance with last summer's overhaul of the financial regulatory system.

They say the bank's troubles indicate that the financial system's post-Troubled Asset Relief Program exposure to toxic mortgages is just as great today as it was in 2008, and that the fallout from the collapse of the housing bubble has not ended.

As if on cue, the National Credit Union Administration added Goldman, Sachs & Co. to the list of investment houses being sued for securities fraud on Tuesday, Aug. 9. And less discussed but potentially more devastating is New York Attorney General Eric Schneiderman's accusations last week that Bank of New York Mellon Corp. legally failed investors in BofA-packaged securities in its role as trustee.

"Restructuring is the only way to solve the problems facing the largest U.S. banks," independent bank analyst Chris Whalen blogged Tuesday. "After years of earning what seemed to be supra normal returns from the 'gain on sale' world of U.S. mortgage originations, the large service banks are now drowning in the same sea of risk that once made them seem so profitable."

L. Randall Wray, an economics professor at the University of Missouri-Kansas City, said American International Group Inc.'s $10 billion lawsuit accusing BofA of fraud in connection with securities backed by mortgages made by Countrywide Financial Corp., which it acquired in 2008, portends a slew of similar suits against all the major MBS players.

"A settlement in this case is possible, but that will not stop the tide of lawsuits," Wray said. "There will be further problems down the road, probably sufficient to bring down several of the biggest banks."

Under the Dodd-Frank Act, regulators can take control of any faltering institution the Financial Stability Oversight Council deems "systemically important" to the financial system at the Treasury secretary's recommendation.

D. Anthony Plath, an associate professor of finance at the University of North Carolina who has followed Bank of America for years, said that is exactly what may happen if BofA cannot stanch the wave of lawsuits or if investors lose confidence in the Charlotte, N.C.-based bank.

"Despite all the concerns about 'too big to fail,' let's see what happens [if] a $2 trillion institution starts to teeter," Plath said.

The latest round of bad news for BofA started Friday, when Schneiderman urged a New York judge to reject an $8.5 billion settlement that BofA proposed to shut down a similar lawsuit brought by a group of institutional investors. Delaware Attorney General Beau Biden then followed Schneiderman's lead. Then on
Monday AIG dropped its $10 billion-plus anvil.

"There's a lot of skeletons in that closet," Sylvain Raynes, founding principal of risk-assessment firm R&R Consulting, said about Countrywide. "They are never going to see the end of this."

Raynes said BofA brought this trouble on itself by not doing its due diligence before buying Countrywide, which was not forced on it by the government the way Merrill Lynch & Co. was.

"They're paying the price for their own stupidity," he said. The merger "was too rushed; they paid too much. ... It did not take a genius to know that Countrywide was going to implode."

A Zamansky & Associates partner representing investors in similar suits stemming from the bursting of the housing bubble said the entire industry will pay for hastily feeding the MBS machine.

"Banks should be more responsible before just issuing risky products and picking up the fees and moving on," Jacob Zamansky said. "They're going to pay [out] many times over what they earned on these deals."

AIG, and others, are expected to target banks beyond BofA.

"I think this is just the opening salvo," Wray said. "A very large percent of the securitizations done during the real estate bubble were fraudulent — especially the 'private label' securitizations."

"Potential losses could be tens of billions or even hundreds of billions of dollars," he added.

BofA has tried several times to definitively quantify its mortgage-crisis losses by announcing broad settlements — such as the $8.5 billion one in July — and signaling its troubles were behind it. But Schneiderman's move and the AIG bombshell have shaken investor confidence that BofA can truly close the books.

"The biggest thing is the uncertainty," said Bert Ely, an independent bank analyst. "AIG's lawsuit could cost $100 million or $10 billion."

Plath, the North Carolina professor, said a big part of the uncertainty is that BofA's exposure is not only on one front. He also cited the fact that the bank can't determine its losses on the legal front.

"They don't know the magnitude of any putback, and their total exposure from lawsuits keeps changing," he said. "Every time they give us a number, it has turned out to be wrong."

Furthermore, BofA bungled what it does know, Whalen said.

Bank of America's "effort to settle the Countrywide claims seems to have been very badly considered," Whalen wrote to clients Friday. "Now [it] is in a worse position than before the July settlement announcement. Investors may reasonably conclude that the settlement amount for this particular area of litigation is going to be well above the $8 billion-$13 billion figure" it announced, he added.

For BofA to get relief, Zamansky suggested it may seek a global settlement of all the lawsuits. Or, if things really get bad, it could ask for another government bailout, Plath suggested. But Whalen, and others,
maintain that a restructuring is ultimately the only solution.

BofA has "not been honest" about problems inside its portfolio or exposure on originations, among other things, Whalen said in an interview.

"I've been saying the same thing for three years: The preponderance of risk that is gathered around this poor company is just too [expletive] big."

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