Judge strikes down SEC settlement with Bank Of America over bonuses

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A US Federal Judge rejected a settlement last week between Bank of America and the Securities and Exchange Commission regarding allegations that the bank lied to its shareholders about bonuses paid to Merrill Lynch executives following the two organizations' merger at the height of the 2008 financial crisis.

The Securities and Exchange Commission (SEC) alleges that Bank of America executives failed to report that top employees at Merrill Lynch were paid $3.6 billion in bonuses shortly before Merrill was acquired by Bank of America. The proposed settlement would have Bank of America pay the US government $33 million in damages with no admission of wrongdoing.

The settlement was struck down by Jed S. Rakoff, a New York US District Court judge, who found that the settlement "does not comport with the most elementary notions of justice and morality."

The judge's sharp rebuke represents an acknowledgment that the agreement worked out between the SEC and Bank of America is a means of letting Bank of America's executives get off scot-free after illegitimately paying their cronies billions of dollars. Bonuses at Merrill Lynch were over 20 times larger than those paid to AIG, and were equivalent to over a third of the TARP money the company received.

Rakoff noted that "The parties were proposing that the management of Bank of America—having allegedly hidden from the Bank's shareholders that as much as $5.8 billion of their money would be given as bonuses to the executives of Merrill who had run that company nearly into bankruptcy—would now settle the legal consequences of their lying by paying the S.E.C. $33 million more of their shareholders' money."

The judge said he struck down the settlement because it would have let "victims of the violation pay an additional penalty for their own victimization," since it is not executives, but shareholders, who would pay the fine.

The SEC alleges that Bank of America "materially lied" to its shareholders in a November 3 proxy statement soliciting shareholder approval of the company's $50-billion takeover of Merrill Lynch. The proxy statement claimed that Merrill would not pay year-end bonuses prior to the completion of the merger, but in reality, Bank of America had already agreed to let Merrill executives take in up to $5.2 billion in additional year-end bonuses and other compensation.

In December 2008, Merrill Lynch executives awarded themselves $3.6 billion in compensation unusually early, despite the fact that their company was on the brink of collapse and had received $10 billion in federal bailout money. On January 1, 2009, the company was officially acquired by Bank of America in a process that had been in negotiation for months. Fifteen days later, Bank of America released an earnings statement showing huge losses at Merrill Lynch in the fourth quarter, prompting Bank of America to ask for additional bailout funds.

In the face of the SEC's claims, Bank of America said that the bonuses were disclosed, but in a separate filing that was not given to shareholders. The Securities and Exchange commission had declined to pursue the Bank of America executives, nominally because the misleading documents were constructed by lawyers, not the bank's executives. Rakoff denounced this argument as spurious, saying "why are the penalties not then sought from the lawyers?"

The deal is further evidence that Mary L. Schapiro, President Barack Obama's new appointee for the Securities and Exchange Commission, under whose watch the settlement was proposed in April, is running the organization no differently from her predecessors. Instead of prosecuting executives' flagrant illegality and wrongdoing, her agency supported a settlement that would merely have penalized shareholders, or more precisely, the US government itself. As the ruling notes, "To say, as the bank now does, that the $33 million does not come directly from US funds is simply to ignore the overall economics of the Bank's situation."

Rakoff observes that "the parties' submissions, when carefully read, leave the distinct impression that the proposed Consent Judgment was a contrivance designed to provide the SEC with the facade of enforcement and the management of the Bank with a quick resolution of an embarrassing inquiry."

The ruling adds, "undoubtedly, the decision to spend this money was made even easier by the fact that the US Government provided Bank of America with a $40 billion or so 'bail out', of which $20 billion came after the merger...what impediment could there be to paying a mere $33 million... to get rid of a lawsuit saying that the bonuses had been concealed from the shareholders approving the merger?"

This is only one of several investigations into Merrill's staggering losses and bonus payments in 2008. Andrew Cuomo, New York state's attorney general, is planning to file a complaint against Bank of America executives within the next two weeks, according to a source cited by the Wall Street Journal.

Rakoff's ruling presents a scathing indictment of relations between banks and their supposed regulators. In the aftermath of the greatest financial crisis in postwar history, the Securities and Exchange Commission wanted to do nothing but hush up the matter of fraudulently-derived executive compensation at Bank of America and Merrill. This is in line with the entire policy of the Obama administration, which stands opposed to any reduction in of Wall Street bonuses or any curbs on the fraudulent practices that led up to the crisis.