Q3 2017 Earnings Call

Company Participants

- Brian T. Moynihan, Chairman & Chief Executive Officer
- Lee McEntire, Senior Vice President-Investor Relations
- Mike Mayo, Analyst
- Paul M. Donofrio, Chief Financial Officer
- Steven Chubak, Analyst

Other Participants

- Brian Kleinhanzl, Analyst
- Elizabeth Lynn Graseck, Analyst
- Gerard Cassidy, Analyst
- Glenn Schorr, Analyst
- James Mitchell, Analyst
- John Eamon McDonald, Analyst
- Ken Usdin, Analyst
- Matthew Derek O'Connor, Analyst
- Nancy Bush, Analyst
- Saul Martinez, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day and welcome to the Bank of America Earnings Announcement. At this time, all participants are in a listen-only mode. Later, you will have the opportunity to ask questions during the question-and-answer session. Please note today's call may be recorded. I will be standing by if you should need any assistance.

It is now my pleasure to turn the conference over to Mr. Lee McEntire. Please go ahead, sir.

Lee McEntire {BIO 6651246 <GO>}

Good morning. Thanks for joining us this morning for our third quarter 2017 results. Hopefully, everybody has got a chance to review the earnings release documents that are available on the Bank of America website. Before I turn the call over to Brian and Paul, let me remind you, we may make some forward-looking statements. And for further information on those, please refer to either our earnings release documents, our website, or our SEC filings.

With that, let me turn the call over to Brian Moynihan, our Chairman and CEO, for some opening comments before Paul Donofrio, our CFO, goes through the details. Over to you, Brian.

Brian T. Moynihan {BIO 1517608 <GO>}

Thank you, Lee; and good morning, everyone, and thank you for joining us. This was another strong quarter across the board for Bank of America. Responsible growth is delivering for our customers and for you, our shareholders, with strong operating leverage, strong credit results and strong expense management. We earned $5.6 billion or a diluted EPS of $0.48 per share this quarter. That is up 17% from the third quarter of 2016.

So thinking back and talking to a lot of you over the last year or so, as we met with you, you'd asked three basic questions: Can Bank of America actually grow while sticking to its responsible growth principles? Can we achieve the $53 billion 2018 expense goal? And can you meaningfully invest in the company at the same time you're reducing the costs?

So what I thought I would do is use a summary on page 2 to answer a few of those questions. So on the first question you can see on page 2, will responsible growth work? I've pointed to a several of the metrics there. We've been operating on this model for some time. First, if you look at this quarter compared to a year ago, revenue grew 1% on a reported basis. And looking at the core lines of business without other, we grew revenue 4%, despite the tough comparison with Global Markets.

If we move to Global Markets, you can see at the core of (02:25) businesses of Consumer Banking, Wealth Management and Global Banking grew revenue at 7%. If you look at what drives that revenue growth, average loans in business segments grew 6% year-over-year, average deposits grew 4% year-over-year, led by our Consumer business, which grew its deposits 9% year-over-year. Assets under management in our Wealth Management business reached $1 trillion this quarter and flows into the assets under management were $21 billion in the quarter, bringing year-to-date flows to almost $75-billion-plus.

Our mobile usage continues to grow. We had 1.2 billion mobile interactions this quarter alone, up nearly 20% from last year and is doubled in the last three years. Our investment banking fees were up 14% through the nine months this year. We did this the right way, with net charge-off ratio still bouncing on decade lows, we're growing with our risk framework and driving a strong risk culture. Nonperforming loans at the lowest level since first quarter of 2008 and our market risk remains low. So we are growing responsibly.

The second question we get asked is can you get to your expense target? In the second quarter of 2016, we committed to achieving a goal of approximately $53 billion in total expenses by 2018, and that's all-in reported expense. At that time, our 12 months leading up to that point was running around $56 billion in expense. So that means we had to take out $3 billion in cost. This reduction meant we also had to overcome a couple years of normal merit increases, revenue-based incentive compensation increases, health care cost increases and other inflationary costs such as lease renewals, et cetera. And we had to do all this, while our volume increased, because we're doing more with our customers and have more clients and customers to do business with.

And we remain on track. This quarter, you can see we reported a little more than $13.1 billion in expenses. Our efficiency ratio moved below 60% on an FTE basis. By the way, that is the lowest level expense since the fourth quarter of 2008.

That was the last quarter before we bought Merrill Lynch. So we reduced the cost in our company equivalent to entire cost structure at Merrill Lynch over those years. Head count is now down to $210,000 and it's down again this quarter. So the third question is, can you continue to invest in a franchise while reducing those costs? So the first thing to think about there is for the first nine months of the year, we spent nearly $2.25 billion on technology initiatives. That's some pure initiatives. Look no further than a branch of your pocket for evidence of that. Customer using our mobile have increased 47% in the past 12 months. Mobile deposits account for 21% of all check deposit transactions. Digital sales account for 22% of all consumer sales.

In this quarter, Zelle came forward, the latest offering we have in mobile area. Bank of America's volumes alone, our volumes through Zelle this quarter were $4 billion in the third quarter. We processed nearly 14 million transactions, and the growth continues. We recently processed a $0.5 billion in a single week. Our customers are using Zelle and we look forward to further growth in that area. We're also continuing to innovate. We're rolling out auto shopping across the country. Home loans, mobile deployment is following that. And as we roll through the next couple of quarters, our artificial intelligence offering, Erica, will come out. We continue also to invest in our physical network by refurbishing nearly all our existing financial centers, which is well underway and will complete over the next couple of years.

We have been and will continue to open centers in markets, where we have a strong commercial banking and Wealth Management client base that lack financial centers due to historical issues. We'll continue to enhance our online brokerage offering, benefiting Consumer and Wealth Management clients. For our Global Banking customers, we've added the availability of CashPro on our mobile devices. We're using artificial intelligence to efficiently prospect business clients and offer client receivables management alternatives to our clients. We're investing also in enhanced whole set of credit underwriting operating model. In our markets business, we are redoing the trading platforms in total.

In addition to the technology investments, we've added 2,000 primary sales professionals over the past 12 months with the relationship bankers, financial advisors, commercial and business leaders. So, yes, we're doing both, investing and finding ways to be more efficient to pay for it, and therefore, lowering our overall expense.

Now we did all of this in an economic environment that still feels very constructive, consistent with growth of 2%-plus. We expect moderate economic growth to continue this year and expect the U.S. to grow a little faster next year, above 2% and outside the U.S. is growing a little – in the mid-3s. For the year-to-date, interesting, in our consumer payments, we're seeing consumer activity pick up. Consumers are spending with those checks written, cash taken out of the ATMs, P2P payments and all the different – and debit and credit cards, 5% more through the first nine months of 2017 than they did in the first nine months of 2016. That's up, a faster growth rate than it has been in prior years.

Debit and credit card spending were up 7% for the first nine months of the year, showing the strong a consumer activity. Our commercial clients continue to perform well. They continue to remain optimistic. They continue to look forward to continued implementation of a pro-growth agenda, particularly focused on meaningful tax reform. Housing starts home prices continue to remain on positive trends. Employment is strong and employers continue to search for skilled workers. So that leads to a solid atmosphere and we see no near-term indications of any change to it.

As we move to slide 3, we show that growing responsibly is not new and is showing sustained progress. As you can see in slide 3, we have delivered positive operating leverage on a year-over-year basis every quarter for the past three years. And by the way, not every quarter had revenue growth. In those quarters, we reduced expenses more than revenue decline. So that remains our focus; continue to drive growth, but on occasions where capital markets might be slower and there might be less growth in revenue, we have to manage our expenses well. And we have to do all of that while we continue to make the investments.

That consistent operating leverage shows up in our businesses. All totaled, we earned $15.7 billion for the first nine months of 2017, up 19% from the first nine months of 2016. On slide 4, you can how the businesses contributed to those results. The businesses are driving earnings improvement and returns above the firm's cost of capital. And they continue to drive their efficiency ratios lower. As you can see, Global Market results are actually down year-over-year for the nine months on a reported basis, but excluding some DDA and prior-year recovery, earnings would be up modestly on consistent revenue growth, despite low volatility and low activity.

As you look at the other businesses, beginning with the Consumer Bank, the years of hard work the team has put in is now clearly showing. The business is driving operating leverage as we optimize our delivery network, continue to digitize the business and follow the customers' behavior and as it changes over time. In our Wealth Management business, the team continues to do a good job and you see earnings were up 10% on a year-to-date basis. We have industry-leading margins in the business at 27% and the leading brands of Merrill Lynch and U.S. Trust. Ahead of us, we have a lot of work to continue to deal with the industry-wide dynamics and margin pressures. Global Banking had a record-setting $15 billion in revenue year-to-date and has the company's best efficiency ratio as you can see.

So, if you think about that, all that sums up in allowing us to return more capital to you, shareholders. For the first nine months of 2017, we have repurchased $7.9 billion in common shares and paid $2.8 billion in common dividends. This totals $10.7 billion comparing to $5.6 billion for the same period in 2016.

So, with that, let me turn over to Paul to give you some other details in the quarter.

Paul M. Donofrio {BIO 1533743 <GO>}

Okay. Thank you, Brian. I'm starting on slide 5. As Brian said, we earned $5.6 billion in Q3, up 13% from Q3 2016; EPS of $0.48 per share, up 17% year-over-year as we reduced diluted shares by 3% over the past 12 months.

Revenue of $21.8 billion was 1% higher than Q3 2016 as NII improvement and higher asset management fees outpaced decline in sales and trading and mortgage banking income. Expenses of $13.1 billion were 3% lower than Q3 2016. We generated more than 3% of operating leverage. The efficiency ratio of 60% for the second consecutive quarter now, 59% on an FTE basis.

Provision expense was $834 million, down modestly compared to Q3 2016 and continued improvement – we see continued improvement in consumer real estate and energy. Return on assets this quarter was 98 basis points and return on tangible common equity was 11.3%, improving both on a year-over-year and a linked-quarter basis.

Turning to the balance sheet on slide 6, overall, compared to June 30, end-of-period assets increased $29 billion, driven by strong deposit growth that funded an increase in loans to customers with the remainder invested in securities and cash.

Loans on an end-of-period basis were up $10.5 billion from Q2, led by commercial activity, while consumer loan growth was mitigated by the continued run-off of legacy non-core loans. On the liability side, long-term debt increased $4.7 billion during the quarter as we took advantage of favorable credit spreads to pre-fund upcoming maturities.

Given that we are now compliant with TLAC requirements, our debt issuance over the next few quarters will likely be more opportunistic. Liquidity remained strong with $517 billion in global liquidity sources and our liquidity coverage ratio was 126%.

Common equity increased more than $4 billion compared to Q2. During the quarter, Berkshire Hathaway converted its Series T preferred stock into 700 million shares of common stock per the terms of their 2011 investment. As a result of this conversion, common equity increased and preferred stock decreased by the $2.9 billion book value of their Series T preferred stock. This issuance does not impact diluted EPS in this or subsequent quarters as the effect of this conversion was already accounted for in diluted EPS.

The remaining increase in common equity reflects $5.1 billion in net income available to common partially offset by the return of capital totaling $4.2 billion through both common dividends and share repurchases. Tangible book value per share of $17.23 was modestly higher than Q3 2016, but decreased 3% versus Q2 2017 as a result of the Series T conversion.

Turning to regulatory metrics and focusing on the advanced approach, our CET1 transition ratio under Basel 3 ended the quarter at 11.9%. On a fully phased-in basis, compared to Q2, the CET1 ratio improved 40 basis points to 11.9% and remains well above our 2019 requirement of 9.5%.

CET1 increased $4.9 billion to $173.6 billion, driven by earnings and the Berkshire Hathaway conversion. The CET1 ratio also benefited from a modest $3 billion decline in RWA as growth in loans and low RWA density assets was offset by continuing optimization of the balance sheet.

We also provide our capital metrics under the standardized approach. RWA increased $15 billion from Q2, driven by loan growth but increases in capital more than offset asset growth resulting in a CET1 ratio improvement of 20 basis points to 12.2%. Supplementary leverage ratios for both the parent and bank continued to exceed U.S. regulatory minimums that don't take effect until 2018.

Turning to slide 7, on an average basis, total loans increased to $918 billion. Note that the sale of UK card, which was recorded in All Other, impacted year-over-year comparison of average loans by $9.3 billion. Adjusting for the sale, average loans were up $26.8 billion or 3% year-over-year. Loan growth continued to be dampened by the runoff of non-core consumer real estate loans and All Other, year-over-year loans and All Other, including the sale of UK card were down $28 billion. On the other hand, loans in our business segments were up $47 billion or 6%.

Consumer Banking and Wealth Management both experienced solid loan growth of 8%. Both businesses continued to see good growth in residential mortgages; Consumer Banking also saw growth in credit card and vehicle loans. Originations of new home equity loans was solid, but overall, loan growth continues to be outpaced by paydowns. In Wealth Management, growth was also aided by structured lending.

Global Banking loans were up 4% year-over-year, led by C&I growth in the U.S. and abroad. On the bottom right, note that we grew average deposits by $45 billion or nearly 4% year-over-year. This growth was driven by Consumer segment's deposits increasing by $53 billion or nearly 9% year-over-year.

Average deposits declined year-over-year in our Wealth Management segment as clients sought alternatives for their cash within brokerage or AUM. Deposit outflows here largely abated in Q3 and ending deposits were slightly up from the end of Q2. Deposits in Global Banking experienced strong growth in Q3, driven by rate actions taken in the quarter to win and defend relationship deposits.

Turning to asset quality on slide 8, credit quality continues to be solid with net charge-offs, NPLs and reservable criticized exposure all showing improvement from Q2. Total net charge-offs were $900 million or 39 basis points of average loans, decreasing modestly from Q2.

Provision expense of $834 million included a $66 million net reserve release. Provision expense was in line with the prior year, but increased $108 million from Q2 as a result of less net reserve releases. Our reserve coverage remains strong, with an allowance-to-loan ratio of 116 basis points and a coverage level 3 times our annual charge-offs.

On slide 9, we break out credit quality metrics for both our Consumer and commercial portfolios. With respect to Consumer, net charge-offs were down from Q2. Included in the quarter were recoveries on the sale of some consumer real estate loans. Partially offsetting this recovery benefit was the negative impact of clarifying guidance from the regulators on bankruptcies, which increased our consumer losses this quarter.

The net effect of all these pluses and minuses was minimal. Consumer NPLs of $5.3 billion were the lowest they have been since Q2 2008. NPLs came down from Q2 levels, and keep in mind, 45% of our Consumer NPLs are current on their payments. Commercial losses were up modestly from Q2, driven by a couple of names, while reservable criticized exposures and NPLs declined.

With respect to the impact of hurricanes, first, let me say that our focus has been on those impacted by the storms, including our employees and customers. One decision we made early was to provide a payment deferral to many of our customers in the impacted areas, delaying some potential net charge-offs in Q3. Since then, we have and we will continue to engage with consumers and businesses in the impacted areas to better understand how we can assist them. As it relates to credit, we have not seen any material impact.

Our overall net reserve release for the quarter did include a modest build related to the storms for losses that are probable, and it goes without saying that we believe we are adequately reserved today.

Turning to slide 10, net interest income on a GAAP non-FTE basis was $11.2 billion, $11.4 billion on an FTE basis. Compared to Q3 2016, which has the same day count and seasonal factors, NII is up $960 million or more than 9% driven by an improving spread between our asset yields and deposit pricing.

The year-over-year comparison also benefited from loan growth and excess deposits deployed in security balances. An additional benefit was higher long-end rates from Q3 2016, which drove lower prepayments, and, therefore, lower bond premium write-offs.

The full quarter effect of the sale of UK card negatively impacted the comparison. Focusing on net interest yield, it improved 18 basis points from Q3 2016 to 2.36% after adjusting for the impact of UK card. Compared to Q2 2017, NII increased $175 million as the benefits from an increase in short-end rates and an extra day of interest as well as loan deposit growth was mitigated by a number of factors.

First, we lost the two months of interest income associated with the UK card book. Second, we raised rates broadly across our Wealth Management business to offer clients a competitive deposit alternative to cash alternatives within brokerage and AUM. Third, we experienced a decline in long-end rates in Q2 and early in Q3, which impacted reinvestment rates as well as increased the write-off of bond premium as mortgage prepayment speeds accelerated. I would note that we also increased deposit pricing for some commercial clients, which had a modest impact on NII in the quarter.

Looking ahead to Q4, assuming no change in interest rates, NII growth will be dependent on loan and deposit growth and pricing. If we get a late 4Q hike, as expected by the market, this should mostly benefit NII in Q1 2018.

With respect to asset sensitivity, as of 9/30, an instantaneous 100-basis-point parallel increase in rates is estimated to increase NII by $3.2 billion over the subsequent 12 months. This is largely unchanged from June 30 and continues to be predominantly driven by our sensitivity to short-end rates.

Turning to slide 11. Our teams continued to deliver on cost management. Net interest expense of $13.1 billion is down more than $300 million or 3% from Q3 2016. Productivity improvements were driven by our focus on digitizing processes and lowering our costs to deliver for our customers. Keep in mind that we are seeing these expense declines, while investment in technology and new sales professionals remains robust.

Compared to Q3 2016, in addition to overall operating cost improvements, we reduced personnel expense, which included costs associated with our UK card business as well as non-personnel expense, which included lower litigation expense. Compared to Q2 2017, expense declined by $600 million, with half of that decline driven by a Q2 2017 charge in anticipation of the sale of several data centers. Q3 also included modest declines from lower severance as well as revenue-related incentives. The remaining reduction reflects broad-based improvement as we drive operational excellence. The efficiency ratio hit our 60% target again this quarter.

With respect to head count, we are down from the prior quarter and continue to see a shift from non-client-facing associates to primary sales professionals, which now make up more than 21% of our head count. We've added more than 2,000 primary sales professionals over the past 12 months.

Okay. Turning to the business segments and starting with Consumer Banking on slide 12. Earnings were $2.1 billion, growing 15% year-over-year and returning 22% on allocated capital. The business created over 800 basis points of operating leverage on revenue growth of 10%, which outpaced expense growth of 2%.

Year-over-year, average loans grew 8%; average deposits grew 9%; and Merrill Edge brokerage assets grew 21%. Revenue growth was led by NII, driven by increases in client balances. Revenue was modestly impacted this quarter by the hurricanes as we took steps to help customers in the impacted areas. We expect the dip in fees and interchange weakness to be temporary as impacted communities begin to recover and rebuild. With respect to expenses, through continued efforts to drive operating leverage, the efficiency ratio improved over 400 basis points to 51%.

Cost of deposits and rate paid, which when combined represents cost of goods sold from a deposit perspective remained steady at a combined rate of 163 basis points in the quarter. Consumer Banking credit quality reflected moderate seasoning and portfolio growth, which drove reserve build of $168 million in addition to the $800 million in net charge-offs. The net charge-off ratio declined modestly from Q2 to 1.18% of loans.

Turning to slide 13 and looking at key trends. As I said earlier, revenue increased 10% year-over-year. Within revenue, mortgage banking income was the only major category that was lower year-over-year, driven by our strategy of holding more originations on balance sheet instead of selling to the agencies as we like the economics of holding these high-quality originations. In Q3, we retained about 80% of first mortgage production on balance sheet.

Looking at revenue more broadly, we believe our relationship deepening Preferred Rewards program is improving NII and balance growth, while mitigating industry pressures on fees as we reward customers for doing more business with us. This is why we continue to emphasize total revenue as opposed to fees in NII separately. Having said that, spending levels on debit and credit cards were up 7% year-over-year and new issuance of credit cards was solid at $1.3 million. Spending levels on credit cards drove revenue increases, but were again largely offset by the rewards to customers. We saw modest year-over-year improvement in card fees as well as service charges.

Focusing on client balances on the bottom left, you can see the success we continue to have growing deposits, loans and brokerage assets. With respect to loans, residential mortgage continued to lead our growth, but we also saw good growth in auto as well as better growth in card than we've experienced in quite some time. We remain focused on prime and super-prime borrowers with average booked FICO scores of at least 760. Client brokerage assets were up 21% year-over-year, driven by strong client flows as well as market performance. Net new accounts grew 6% from Q3 2016.

At the bottom right, you can see deposits broken out. Our 9% year-over-year average deposit growth continued to outpace the industry, while the rate paid remained low and stable. Importantly, 50% of these deposits are checking accounts, and we estimate that 90% of these checking accounts are the primary accounts of households. Expenses were up modestly compared to Q3 2016 despite strong revenue growth as optimization and digitalization savings were more than offset by investments in refurbishing branches and technology initiatives.

Turning to slide 14, let's look again this quarter at digital banking highlights as they continue to shape the way we do business with our customers. As you can see, the year-over-year growth in these metrics is impressive. We remain the leader in digital banking. We now have nearly 24 million mobile users, another 11 million online with us. Within the 639 billion in total payments shown here, note how digital continues to grow as customers move away from cash and check. This migration is helping us lower expenses and reduce operational risk. Further, digital growth of credit and debit card usage is accelerating as e-commerce grows and more payments are taking place within merchant applications like Uber and Starbucks.

Within total payments is person-to-person, and I want to spend a moment on Zelle as Bank of America has been one of the lead banks introducing this P2P capability for customers. Note the steady adoption by Bank of America customers of this online app, which makes it easier to spend, request and even split person-to-person money transfers. Also note on the bottom left, the growth in mobile channel usage. This quarter we saw nearly 1.2 billion logins, which is up 19% versus Q3 2016.

And more than 21% of all check deposit transactions are now done on mobile devices. This represents the volume of 1,100 financial centers. And while important in terms of how we transact with customers, mobile has also become important in terms of how we connect with our customers. One example of that is the reduction in our call center volumes, which are down 13% over the past three years.

And we continue to innovate. This quarter we rolled out an app in several states for mobile auto shopping, which will soon be followed by a mortgage shopping and fulfillment app. Excuse me, I meant mobile auto shopping, which will soon be followed by a mortgage shopping and fulfillment app that we call Home Loan Navigator. Still even with all this digital activity, it is important to note that we still have 775,000 people a day, walking into our financial centers across the U.S. Many of these customers still use our centers to transact, but many use the centers as financial destinations where they can learn about products and services, work face-to-face with a specialized professional and generally improve their financial lives.

That's why we continue our multiyear branch refurbishment program. And it is also why we continue to add new financial centers in markets where we have never had a Bank of America center, but we have a strong presence in other lines of business. This quarter, for example, we opened centers in Denver, Minneapolis and Indianapolis. In addition, we are testing advanced centers which utilize video-assist ATMs and other video-conferencing capabilities in areas where it makes sense to do that.

Turning to slide 15. Let's review Global Wealth and Investment Management. We produced earnings of $769 million, up 10% from Q3 2016, a pre-tax profit margin of 27% and return on allocated capital of 22%. The market and client activity once again provided a tailwind for asset management fees, while at the same time, transaction revenue continues to face headwinds in the industry evolves – as the industry evolves and adapts to new fiduciary requirements and the increasing adoption of passive investing.

In all, revenue grew 6% year-over-year led by NII and a 13% increase in asset management fees, partially offset by lower transactional revenue. We saw nearly $21 billion of AU inflows this quarter, continuing the strength of $57 billion in the first half of the year. Year-over-year expenses were up 4%, driven by revenue-related incentives. Other expenses were managed well, creating a modest operating leverage in the segment.

Moving to slide 16. We continue to see overall solid client engagement. Capital balances rose to nearly $2.7 trillion, driven by higher market values, solid AU inflows and continued loan growth. Average deposits of $240 billion were down $5 billion from Q2. The increase in deposit rates at the end of the second quarter helped to mitigate the movement of client balances from deposits to other cash investment alternatives within AUM and brokerage. The decline in NII from Q2 to Q3 reflects the cost of this rate increase.

Average loans of $154 billion grew 8% year-over-year and reflect the continued trend of investment clients deepening their relationship with us. Loan growth remain concentrated in consumer real estate as well as structured blending.

Okay. Turning to slide 17, Global Banking earned $1.8 billion. This was a 13% increase from Q3 2016. Return on allocated capital was 17%, and stable with last year, despite a $3 billion increase in allocated capital. Year-over-year revenue growth of 5% was driven by improved NII, reflecting solid loan and deposit growth compounded by rising short-term interest rates. We also grew IB fees modestly year-over-year, led by debt and advisory fees. Revenue improvement coupled with lower expenses created operating leverage of 650 basis points and an efficiency ratio of 43%.

This expense comparison versus Q3 2016 reflects savings offset by continued technology investment. We also added new bankers, while keeping overall head count relatively flat over the year. We're also deploying more AI capabilities in this business. The focus so far has been on improving client prospecting and more intelligent receivable processing for clients. Provision expense of $48 million remains low and is down from Q3 2016 on improvement across most of the portfolio particularly energy.

Global Banking grew loans 4% year-over-year. As Brian mentioned, our loan growth in Global Banking has been pretty consistent over the past three or four quarters at 4% to 6% on a year-over-year basis. When compared to Q2, I would note an increase in loans near the end of the quarter drove end-of-period balances meaningfully above the average.

Looking at the trends on slide 18 and comparing to Q3 last year, average loans of $346 billion were up nearly $12 billion. With the exception of CRE, loan growth was fairly broad-based with slightly elevated growth in Asia. Loan spreads were stable compared to Q2 2017, but compressed compared to the year-ago period. Average deposits rose 3% compared to Q3 2016 with most of it concentrated in Q3, given the rate action this quarter.

Total investment banking fees of $1.5 billion were up modestly from a strong Q3 2016. Debt underwriting remained strong, while equity underwriting was down from a year ago. Growth in advisory fees also benefited the year-over-year comparison. Year-to-date, we remain ranked number three in investment banking fees with fees of $4.6 billion, which is up 14% from 2016.

Switching to Global Markets on slide 19, the business had a solid quarter, although it's a tough comparison against a strong Q3 2016, for the reasons you all know. Global Markets generated $3.9 billion in revenue and earned $770 million after adjusting for a modest impact from DVA. Given the tough comparison, we view this quarter as solid, despite the fact that sales and trading revenue of $3.2 billion excluding DVA declined 15% from Q3 2016.

Excluding net DVA and versus Q3 2016, FICC sales and trading of $2.2 billion decreased 22%. Within FICC, the decrease was driven by less favorable market conditions across credit products, especially mortgages, combined with lower volatility in rates products in the current quarter.

Equity sales and trading was up 2% year-over-year to a little less than $1 billion, benefiting from growth in client financing activity. Lower volatility also drove lower secondary market activity in equities.

With respect to expenses, Q3 2017 was 2% higher than Q3 2016, driven by increased technology investment in our trading platform as well as numerous regulatory requirements such as MiFID II, Volcker and UMR, among others.

Moving to trends on slide 20 and focusing our attention – or your attention on the components of our sales and trading performance on a year-to-date basis for just a moment. While the quarter is down from Q3 2016, as you can see in the lower left box, sales and trading revenue has been fairly consistent on a year-to-date basis for the last three years at roughly $10.5 billion.

And note that we have achieved this stability, while reducing VaR and RWA. And just as important, if not more important, this revenue consistency reflects the value to our clients of our diverse product set and sales and trading capabilities in every major market across the globe. Without this strength and diversity, one would have seen a lot more revenue volatility as client activity shifted from a product and market perspective over the last three years.

On slide 21, we show All Other, which reported a net profit of $217 million. This is an improvement of roughly $400 million compared to Q3 2016. This quarter included a lower litigation expense, while reps and warranty expense increased a little more than $100 million over Q3 2016. Reps and warranty provision is recorded as contra revenue in mortgage banking income and was the result of advanced negotiations with certain counterparties to resolve several outstanding legacy issues.

Also note that mortgage banking income in Q3 2016 included a benefit of roughly $300 million in net MSR hedge results. And also remember that this is the first quarter without the UK card business which was sold in June. So, in addition to two months of approximately $250 million in normal quality revenue generated from UK card, Q2 also included a $795 million benefit from the sale of UK card that was mostly offset by tax expense in that quarter.

And when making expense comparisons, remember, in addition to lower litigation, Q2 also included a $295 million impairment charge on three data centers that we are in the process of selling. Lastly, note that the effective tax rate for the quarter was 29%.

Okay. Just a few summary points to wrap up. Again, this quarter, we created positive operating leverage by growing revenue while lowering expenses. And as Brian pointed out, this continued a trend of many quarters of positive operating leverage. For years, we have been focused on growing responsibly while improving operating efficiency and making our growth more sustainable. And importantly, we have stuck to and not compromised our client and risk frameworks while doing so.

NII growth is benefiting from the value of our deposit franchise and continued loan growth in a modestly improving world economy. Asset quality remains strong as net charge-offs, NPLs and commercial reservable criticized exposure all declined. We continued to invest in new technologies and capabilities, while adding sales professionals in certain businesses. And we did all this while nearly doubling the amount of capital we returned to shareholders this year versus last year.

This tells us that responsible growth is working and that we are well positioned to continue to invest in and grow with our customers and clients as the economy continues to improve.

Thank you. And with that, we will open it up to questions.

Q&A

Operator

Thank you. And we'll go first to the line of Nancy Bush with NAB Research. Please go ahead.

Q - Nancy Bush {BIO 1495529 <GO>}

Good morning. Brian, I have a question on digital banking. I guess, right after the crash when you guys sort of first began to emphasize digital and mobile banking, you were sort of the leader in the industry in that regard. And do you still feel that you have that leadership position? Is it important that you keep it? And what are your thoughts about what you need to do to do that?

A - Brian T. Moynihan {BIO 1517608 <GO>}

I think we have leadership position as told to us by other people and how they rate people in terms of activities and capabilities and things like that. But most importantly, it's how your customers use you and what you see going on. So if you look at the – page 14 that Paul took you through, you can see the growth in transactions and trends in activity. And, well, you mentioned that the drive after the crisis, but the reality is, is the drive started before the crisis. And we were one of the first apps available on smartphones way back to the start of the iPhone. And so that helped us grow quickly. But it is a core platform for us. The question is how do we drive all its feature functionality.

The deposits that go through on a daily basis are equivalent to 1,000 branch activity in deposits, to give you an example. So it's moved major amounts of activity. We're excited about the Zelle payment levels because, at the end of the day, we have $5 billion that we spend a year on cash currency, checks moving around our company in the system. The way we're going to get there is by coming – digitizing those and eliminating cash and driving that.

And so things like Zelle, while they're small numbers compared to all the other payment forms today, the pace that they're growing at with the digital wallets and another things will help drive it there. So we feel we're a leader. We expect to be a leader. The activity grows faster. And I think you put it against any kind of mobile digital person out there, 1.2 billion customer interactions in the quarter shows you that people believe that it's must be pretty good.

Q - Nancy Bush {BIO 1495529 <GO>}

Is there a direct relationship or is there any kind of quantification that you've done of X mobile transactions means Y fewer branches? Is there that direct a relationship?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yes and no. Yes, in a sense that we know the cost of the various things, and a branch transaction for deposit is 10 times more than a mobile transaction. But, remember, at the same time, we're investing heavily in the high touch side of our house, 2,000 more salespeople, a lot of those in Consumer, refurbishing all the branches, building out branches, and things like that. Because at the end of the day, 20%-odd of sales are on digital and mobile, but 80% aren't. And because of the nature of the intimate customer discussions, because of the nature of what customers want to discuss and have face-to-face help on, the branches are critically important to that.

So the real question is you have to have both to be successful. The model doesn't work as solely one or the other, and the model of having both works. And that's where you can see the activity growth. Think about the deposit growth year-over-year in Consumer, $50-odd billion and start to think about that in the context of activity.

Q - Nancy Bush {BIO 1495529 <GO>}

Okay. And just one quick follow-up for Paul. Paul, you mentioned in Global Banking that all categories of loans grew except CRE. Is that a self-selection? Or could you just expand on that a bit?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yes. Sure. We instituted a – okay, a year ago now, if not longer, we pulled back a little bit on CRE. So we're still servicing customers there. We're still making loans, but we're not – we're just being a little bit more cautious. And so you're not seeing a lot of growth in our CRE balances. And I would point out that that kind of makes a 4% growth all that more interesting given our stance there.

Q - Nancy Bush {BIO 1495529 <GO>}

Okay. All right. Thank you very much.

Operator

Thank you. We'll go next to the line of Glenn Schorr from Evercore ISI. Please go ahead.

Q - Glenn Schorr {BIO 1881019 <GO>}

Hi, thanks.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Good morning, Glenn.

Q - Glenn Schorr {BIO 1881019 <GO>}

Good morning. A little drilling down on your comments on deposit cost drive. So we go from, I guess, 8 basis points last year to 24 basis points this – or 11 basis points to 24 basis points over the last quarter. How much of that increase is what you mentioned in Wealth Management? I heard your comments on the bringing them a competitive cash alternative. I'm just curious, is it CD versus money market? Is it all coming from current clients? Thanks.

A - Paul M. Donofrio {BIO 1533743 <GO>}

Mostly in Wealth Management, and it's – I wouldn't say it's in one place or another. It's cut across a lot of the different deposit products we offer to that community of investors and depositors.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Glenn, if you go to page 10 of the supplement package, you can see the comparison of the third quarter last year to this year and you start to think about some of the numbers you were citing. But if you look at the different categories, you're going to see that most of them was in the now money market, which is – that's where the Wealth Management business is. And of the $240-billion-odd number in there, about $140 billion of it is really people's invested cash. And so, if we make an allocation like we did in the second quarter to less cash and more equities, that actually brings deposits out. And then people are obviously thinking it's investment cash.

These are accounts that might have $5 million in securities in it and $500,000 of cash. So obviously, the rate structure moves in that. But if you think about it across a year, there's about a 75-basis-point increase in Fed funds and you start to put these numbers against even Wealth Management's relatively modest in terms of change in the overall.

The other thing that drives our profitability is, if you look at that page, go down, and remember that the noninterest-bearing account deposits are still zero and they grew –

they're $436 billion of noninterest-bearing accounts. If you look in the Consumer side of that, you know that drives the profitability and that's where it's come from.

Q - Glenn Schorr {BIO 1881019 <GO>}

Got you. And so there's – a competitor too had put out some high-priced or high-rate CDs in an effort to gather new client money. This is more of just compensating clients for being good clients, sharing a little bit of the love with them.

A - Paul M. Donofrio {BIO 1533743 <GO>}

I would not say we're...

A - Brian T. Moynihan {BIO 1517608 <GO>}

CDs are down $4 billion at Bank of America year-over-year.

Q - Glenn Schorr {BIO 1881019 <GO>}

I appreciate that.

A - Paul M. Donofrio {BIO 1533743 <GO>}

This is about providing our due-in (49:53) clients with an alternative, a deposit alternative, if they want to take it, since they have options in AUM and brokerage for some of their excess cash.

Q - Glenn Schorr {BIO 1881019 <GO>}

Okay. Cool. And I'm just curious to follow up on the comment you guys had in the slides on targeted growth and client-financing activities in equities. Is that just growing PB with the clients?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yeah. We talked about that last quarter where we made a decision to add some balance sheet to our equities business. We see an opportunity there. We've made a lot of investments in technology. We've got great relationships. And there's an opportunity to add a little bit more leverage to that business if we provide some balance sheet. So we did that last quarter and we continued that this quarter. And it's having an effect. Like you said, it's PB, but it's also synthetic PB in Europe. So it's both synthetic and physical.

Q - Glenn Schorr {BIO 1881019 <GO>}

All right. Thanks very much.

Operator

Thank you. We'll go next to the line of John McDonald with Bernstein. Please go ahead.

Q - John Eamon McDonald {BIO 1972557 <GO>}

Hi. Good morning. Wanted to ask about expenses. The magnitude of improvement was nice surprise this quarter. I think you were targeting kind of a $100 million year-over-year improvement and you got something closer to $300 million or more. Just wondering where did you kind of outperform your own expectations on expenses this quarter? And is this run rate ballpark kind of good jumping off-point, Paul?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yeah. I would say, we feel great about the work we did. We've always talked about expenses not being a straight line, the same line every quarter. This quarter we did maybe a little bit better than other quarters. You're right. It was down about $300 million year-over-year. And those expense reductions were broad-based across personnel and non-personnel.

Q - John Eamon McDonald {BIO 1972557 <GO>}

And in terms of next year when you think about the $53 billion target, doesn't look like you might need it, but do you have any expectations that the roll-off of the FDIC special assessment kind of will help you get to that target? And just maybe a reminder of how much that expense stepped up for you?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yeah. Look, we – it's a good question. I think the industry was assuming that that would end in the second quarter. It looks like it may extend to the third quarter, because we're not going to get to the level they need to get to. So that actually hurts us. And that's why, we always say, we're going to get to approximately $53 billion for full year 2018. There's a lot of things that can happen. I don't know the exact amount. Is it roughly around $100 million quarterly?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yeah.

A - Paul M. Donofrio {BIO 1533743 <GO>}

It's around $100 million quarterly. So it's a material number.

Q - John Eamon McDonald {BIO 1972557 <GO>}

Okay.

A - Paul M. Donofrio {BIO 1533743 <GO>}

I think it's a little more than $100 million, frankly, but I can get back to you on that.

Q - John Eamon McDonald {BIO 1972557 <GO>}

Okay. And then, I guess, just on capital return, Brian, with that CET1 growing nicely, anything that you could see now that would stop you from approaching more of a peer capital payout next year? And then, can you just remind us what kind of CET1 ratio would be a good target for you knowing what you know now about regulatory minimums?

A - Brian T. Moynihan {BIO 1517608 <GO>}

A couple of things. One, yeah, we would expect to keep moving up the ladder in terms of capital management this year. 88%, I think, is a number and you'd expect us to keep pushing forward. And two, on the levels, we're at 9.5%. You'd add 50 basis points to 75 basis points on top of that. The SIFI buffer levels can bounce around on you, but you think about somewhere around 10% to 10.5%, and if you subtract that from the 12%, that's a good amount of excess capital.

Q - John Eamon McDonald {BIO 1972557 <GO>}

Okay. And just one quick follow-up, Paul, on that FDIC expense roll-off. That's in the numbers now. You're kind of running close to almost the $13 billion per quarter, it's almost $53 billion annualized. So you're just saying that if you didn't get that step down, it gets a little tougher to get to the target?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yeah. Look, the target now goes back to the middle of 2016. We said at that time, we would achieve approximately $53 billion for full year 2018. So obviously, it's just a little harder if FDIC doesn't roll off in the second quarter and extends in the third quarter. But we're going to get there, either way.

Q - John Eamon McDonald {BIO 1972557 <GO>}

Got you. Okay. Fair enough. Thanks.

Operator

Thank you. We'll go next to the line of Betsy Graseck with Morgan Stanley. Please go ahead.

Q - Elizabeth Lynn Graseck

Hi. Good morning.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Morning, Betsy.

Q - Elizabeth Lynn Graseck

Couple questions. One, as we go towards the $53 billion, can you just give us a sense as to the source of the improvement Consumer versus corporate?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yeah, Betsy, I think if you look at the quarterly progression across all expense category, it comes from everywhere. And so it comes from the data center configurations that we took a charge to move a lot of stuff last quarter. It comes from continuing to shed real estate occupancy costs, and it comes from lower head count. That was down 1,000 this quarter. It comes from taking out the spans and layers for the thing we called organizational help. But if you think of it more strategically, it comes from basically applying technology and digitizing processes.

And so across our wholesale banking, credit underwriting initiatives I talked about, we've been able to save about 20% of the head count there by consolidating our activities and bringing their activities together. We'll have another big chunk as we go to apply the technology that we are developing that is not yet deployed. And so it's a thousand ideas; It's – I mean, thousands of ideas. It's literally across the board. And the team does a great job of just going after it piece by piece by piece.

And then, we can manage the sort of repositioning costs by getting ahead of it and doing it on a rational basis, so that attrition – we'll hire 8,000 people this quarter to maintain our head count sort of neutral or down a bit. So we have lots of chances not to hire people and continue to shrink the company when we apply this technology

Q - Elizabeth Lynn Graseck

I'm just thinking about the digital efforts. Obviously, you've put a lot of time in the call on the Consumer side.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yeah.

Q - Elizabeth Lynn Graseck

Just wondering rate of change on corporate, is that where you think the digital efforts are picking up?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yeah, there'll be more there because of like trade finance, we've started digitizing more processes. And if those processes would prove out, we'll drive it. There's a lot in the back office of the securities clearance capabilities that is going on. So the numbers are – Consumer always dominates in terms of the numbers in a lot of ways, just if you think about it, but GWIM has a bunch of digitization efforts, a bunch that saves statements. And we send out 12 statements. If we can get people to take e-statements, that saves 12 times a year times whatever it costs for that particular statement. So these things are never – if there was some silver bullet you could shoot and take care of it all at once, we would have shot it already. This is just hard work.

Q - Elizabeth Lynn Graseck

So then, the follow-up is a question I get from people a lot of times, which is we get the expense improvements. Are there any deep pressures that we should be baking in here when you talk about cash management, fee rate, some of the FinTech disruptors look at these fee pulls and say, oh, this is too high, I'm going to go after that. I'm assuming that you're staying ahead of that threat. I'm just wondering is there a fee rate that we should be making sure that we're including when we get to the expense side?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yeah. I mean, I think we've given the guidance on the expense side. If you think about something like in a global transaction services platform, cash management as people call it, there has always been this loss in revenue that you're fighting against when paper – which people pay us more the process turns to digital, we lose revenue, but we save expense at a faster rate. That has been going through the numbers for the last several years.

So the revenue growth we see in cash management takes that all into account. So it's more customers, more activity, fighting off where the customers are converting cash to digital. So, yes, that's a part of it, but you're seeing on our run rate. There's nothing sort of ahead of us that's unusual compared to the quarter-to-quarter sort of picking a way at us that goes on in that regard.

Q - Elizabeth Lynn Graseck

And then, Consumer expense ratio of 51% that – as you're getting more people on to your Zelle platform, et cetera, is there a line of sight to that going sub-50% at some point?

A - Brian T. Moynihan {BIO 1517608 <GO>}

I think through both the revenue lift they get as the rate structure rises and good expense management, we'd expect that it should move down below 50% at some point. But we never say to people where do we think it can get to some big target. The Consumer teams have set some targets. I said don't give people targets, because they're going to think that that's success. We don't know where it goes.

In other words, I'm not talking about next quarter, but over multiple years, when you continue to drive the revenue expense play here because the accumulating core transaction deposit account and getting it from $2,000 over the last 8, 10 years to $6,000 per account is a tremendous revenue lift by focusing primary accounts as the number of accounts actually fell by 10%. And so that dynamic is what we're after. So, yes, it'll move down, but I wouldn't – we never put that success because then people quit working.

Q - Elizabeth Lynn Graseck

Got it. Thanks, Brian.

Operator

Thank you. We'll go next to the line of Mike Mayo with Wells Fargo Securities. Please go ahead.

A - Mike Mayo {BIO 1494617 <GO>}

Hi.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Good morning, Mike.

A - Mike Mayo {BIO 1494617 <GO>}

Yeah. Your branch account continues to go down, I guess, down 3% year-over-year. But deposits are up 4% year-over-year. And I'm trying to get a distinction between retention of deposits when you close branches and retention of customers. Because according to your 10-K from 2015 to 2016, the number of accounts declined by about 2%, but at the same time, deposits continued to grow just like the entire decade. So my question is what is your retention rate of deposits? And what is the retention rate of customers when you close a branch today? And why the difference?

A - Brian T. Moynihan {BIO 1517608 <GO>}

The deposits to Consumer just, Mike, which are more in small business, which are more related to your thing, we're actually up 9% year-over-year, not 4%. That's the all-in corporate level, including GWIM and commercial. But if you look at across time, it really depends on where you're closing the branch obviously and what's nearby. But the retention rates continue to go up over time, because the physical plant becomes less dominant in the relevance of the customer.

And so what we're doing is fine-tuning the branch account and often consolidating into a bigger branch that we've invested heavily into the quality of the branch itself, the numbers of people there. So our branches are getting bigger in terms of numbers of people in them and smaller in terms of account.

When you think about it, the customer fall-off in terms of the numbers of accounts was really continuing to focus on our primary account. So as we do that, the balances are up twice in the accounts, I think, over the last 7 years or something like that and the account numbers are down from 34 million to 31 million. That was all driven by our view that we had to get to the primary account, because that's where the product could be made in the core transaction capabilities there. So we closed a lot of people. People ran off who were (01:01:46) using us as a secondary or a third bank just because they loved our distribution of ATMs and things like that and basically we have emphasized primary account sales.

A - Mike Mayo {BIO 1494617 <GO>}

So I'm not sure if you can disclose this. So what is retention of deposits when you close a branch today? And what was it a few years ago?

A - Brian T. Moynihan {BIO 1517608 <GO>}

We don't disclose it. We don't disclose it separate, Mike, that's all in there. So in that 9% growth is everything we did, so.

A - Mike Mayo {BIO 1494617 <GO>}

Okay. And just sort of last question. You mentioned something, digital banking is up, mobile banking is up. You mentioned your 1,100 branches, that's the equivalent of it. That's good. So have you reached a tipping point where you can go from 4,500 branches down to 3,500 branches or 4,000 branches? How far can you go?

A - Brian T. Moynihan {BIO 1517608 <GO>}

That always depends on the customer behavior and other factors. We are deploying new branches, hundreds of them over a multiyear period, into places we didn't have branches before located more strategically given circa 2017 and beyond banking. So we don't put a – again, it's not a number we target; a number. What we target is a more and more efficient system. And so each day, 0.75 million people come into our branches and our teammates serve them well and our scores at those branches are at all-times highs in terms of satisfaction. And 80% of sales go on in that space. So I wouldn't want to cut them back at one branch more than the customer wants us to do it by evidenced by their behavior.

A - Mike Mayo {BIO 1494617 <GO>}

All right. Thank you.

Operator

Thank you. We'll go next to the line of Steven Chubak from Nomura Instinet. Please go ahead.

A - Steven Chubak {BIO 18457976 <GO>}

Thanks. Good morning. I have a follow-up question regarding the discussion earlier about GWIM deposit competition and just some of the efforts that you cited to compete with other cash alternatives. I was hoping you can quantify the actual magnitude of deposit price increase that we saw in the quarter, and maybe just give a little bit more context as to what prompted the action?

And, Paul, I know you gave some color here. I'm just trying to get a better understanding as to whether this was really driven by increased competitive pressures, or is it more a function of the DOL which actually requires that some clients receive reasonable compensation on some of their assets, including cash?

A - Paul M. Donofrio {BIO 1533743 <GO>}

I don't think it's – it's not a function of the DOL. It's a function of our desire to give our customers an alternative to leave their money in a deposit account at Bank of America as opposed to seeking other alternatives within our AUM and brokerage platforms. So that's what's driving this. It's a meaningful increase, but it's nothing. When you think about the 100 basis points that we've seen here, it's not a significant amount.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Just philosophically, we say to our team we have to maintain the operating leverage given the relative pricing against the rate curve, because the rate curve, you know, we got the zero floors for so long, and so they have to grow faster in the market; 4% or 5% at least you've got to grow deposits, and you've got to maintain the pricing discipline.

What happened to GWIM, frankly, is they got a little behind the curve and they had to move in a single quarter, and they did. And so what you see in the period-end deposits, even though the average I think was down, period-end actually is up. And so they were able to shut down some of the run-off, as Paul just described. But it's really localized in the GWIM business and it's really driven by a subset of those deposits which are in asset management accounts and in brokerage accounts that are a part of an investment strategy that is different than transaction or checking accounts and things that are driving both in our commercial business and our consumer business.

And so that's why you see if you go look at page 10 and kind of sort through it, you'll see there's differences, and it's really narrowly in the area that has to do with really investment cash rather than transitional and transactional cash.

Q - Steven Chubak {BIO 18457976 <GO>}

Thanks for that color, Brian. And so my understanding then is that if we do see rate hikes from here, because much of this increase was a function of your efforts to catch up with the competition, that should we see an in-trajectory increase? Or how should we think about the outlook from here if we get additional rate hikes?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Well first, let me say that our outlook on NII, absent any change of rates, is going to be dependent on loan and deposit growth offset by deposit rate pay, which is mostly going to be driven here by competitive factors. So if we get a 25 basis point rate hike in December, again, most of that we'll see in the first quarter the benefit, and it's going to depend on what our customers need and want and what the competitive dynamic is. I mean, I don't know how else to answer that question. We don't know yet what we're going to do. We have to see how the market develops.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Look, but secondly, in the $3.2 billion for 100 basis points is modeled in a rate of change relative to that interest rate change for deposit pricing. We have bettered that, and because of the power of the franchise and the other things and we'd expect to continue to maintain that discipline.

Q - Steven Chubak {BIO 18457976 <GO>}

Got it. And just one more from me on the credit side. The trends there continue to be quite positive; appear to be doing a lot better than many of your peers in that regard. I know the guidance that you had given previously, at least in the near term, was that provision should approximate net charge-offs. We did begin to see, though, some healthier build in consumer. I'm just wondering how we should think about then near-term provision trajectory from here.

A - Paul M. Donofrio {BIO 1533743 <GO>}

We still think provision is expected to roughly match net charge-offs. You could see some modest increase as we bounce around the bottom with respect to net charge-offs in commercial and as we build allowance in support of loan growth. However, these factors may be offset by the release of non-core consumer real estate and energy, as we've sort of been experiencing here over the last few quarters. So no change there.

Q - Steven Chubak {BIO 18457976 <GO>}

Okay. I mean is $900 million as like a charge-off run rate, at least in the near-term a reasonable expectation?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Over the last five quarters, the average has been $900 million.

Q - Steven Chubak {BIO 18457976 <GO>}

Got it. Thanks so much for your help.

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yes.

Operator

Thank you. We'll go next to the line of Matt O'Connor from Deutsche Bank. Please go ahead.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Good morning, Matt.

Q - Matthew Derek O'Connor

Good morning. I was wondering if you could just elaborate a bit in terms of what you're seeing on the loan demand side, both on the commercial corporate as well as the consumer. And obviously, the industry has slowed down overall. You made some comments about seeing more activity in pockets of consumer. And then along with that, just your outlook for loan growth in the near term here.

A - Paul M. Donofrio {BIO 1533743 <GO>}

Look, we've been experiencing solid loan growth in Consumer and GWIM and in – on the wholesale side in Global Banking, you saw that again this quarter. We don't – so we talk about loan growth for the whole company being driven by deposit growth. And so if you think about our deposit growth and the size of our deposits relative to our loans, every quarter we grow deposits and we put as much of that to work as we can in loan growth. And whatever doesn't go to loans and client growth goes into the investment portfolio or cash. So if you're growing deposits sort of mid-single digit, that means you're going to grow total loans low-single digits. We don't think that's going to change, given the current economic environment. But as you've seen because we have a significant runoff portfolio in all other, that has translated into mid-single-digit loan growth in our business segments and that's what we're comfortable with.

Q - Matthew Derek O'Connor

And then as we think about the deposit growth driving the balance sheet growth, you've got this flatter yield curve and some people – my personal view is if you get additional increase in the short end, you might have further flattening. I'm just wondering the thought process to keep building the securities book and the mortgage book, you're seeing some banks shrinking the securities book and building cash instead, and obviously, there's the cost of doing that. But just the thought process to keep building securities here as the curve has flattened pretty meaningfully.

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yes. Look, we are always, always thinking about the trade-off between earnings liquidity and capital where we have a risk framework that we operate in with respect to the securities portfolio. But remember, when you're growing deposits in Consumer 8%, those are, we believe, high-quality deposits. So they have a meaningful duration, and you've got to find investments on the asset side to match what you believe the duration of those deposits are. So we're very thoughtful about it. We think about it all the time. We haven't made a lot of changes into how we're operating. We're operating within our risk framework, and we feel good about kind of what we're doing there.

A - Brian T. Moynihan {BIO 1517608 <GO>}

I think one of the things to remember is that, as you think about deposits, in our $1 trillion plus of deposits, we have significantly more consumer personal deposits than anybody else does, which then, if you think through the resolution planning and how those are treated and all that stuff, those deposits are extremely valuable.

You think of Consumer, it was 4 basis points last year and 4 basis points this year. You're going to continue to grow those because, unless the curve flattens in a way that would be below 4 basis points plus the FDIC, you'd start to think of – which no one thinks it is going to do – that it's still a very valuable idea to generate more customers and generate more deposits. But we continue to really push that with – it's almost $900 billion in deposits in our GWIM and Consumer business, which are tremendously valuable in terms of what drives this franchise's profits. So there's no way we're turning down more customers with the good core deposits.

Q - Matthew Derek O'Connor

Yes. I guess the point I was getting at is you're paying up a little bit on the deposit side in the Wealth Management business. You're paying up a little bit on the Global Banking side. And on the one hand, you can afford to pay up to help out the customers and keep them using our products, but at the same time with a flatter yield curve, it just makes it less economical to do so, I would think.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Yes, but we – I mean, think about the all-in cost. It's still very advantaged. It costs us $600 million a quarter for the $1.2 trillion in deposits, and so just remember to think about that a second and you'll think that there's a lot of advantage in any yield curve.

A - Paul M. Donofrio {BIO 1533743 <GO>}

The question is obviously focused on the right thing, it's focused on the economics, but remember, these are our customers and we want to make sure that they have the right alternatives for them to make good decisions about whether they want to keep a deposit or whether they want some other alternative.

Q - Matthew Derek O'Connor

Okay. Thank you very much.

Operator

Thank you. And we'll go next to the line of Brian Kleinhanzl from KBW. Please go ahead.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Yes. Good morning.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Morning.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Morning. The first question was on the first mortgage production that you mentioned. You said that you're putting most of that on the balance sheet. Could you just give kind of a description of the type of paper that it is? Is (01:13:44) conforming? And then what's that do to the duration of the loan book for that consumer?

A - Paul M. Donofrio {BIO 1533743 <GO>}

These are our customers who are originating a mortgage either through purchase or refinancing. And we like the risk profile. We know them. We're all focused on primes and super prime. So it's mostly nonconforming but there is some conforming in there. And we still are selling some to the agencies, and obviously, that adds duration to the asset side to the extent that it starts to gain a lot but we'll manage that. And remember, we're adding deposits.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Also, don't think that we don't manage – that we manage that rate risk through a whole bunch of things including derivatives and stuff too, so it's not like we just sit there and throw the long assets on and leave them there.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Okay. Thanks. And then you did call out the hiring of the sales staff up about 2,000 year-on-year. How do we measure the success of those hires? How much of that is already in the run rate? Was it an opportunity to take market share? Were you understaffed in certain areas? How should we think about the increase in sales staff?

A - Brian T. Moynihan {BIO 1517608 <GO>}

How you should think about it is that you can't grow in a business which is largely driven by face-to-face interaction for the Wealth Management business and the commercial business in total and a large part of the Consumer business. If you don't grow on your sales force, you can't grow your production. If you aren't growing your production, you can't grow your balances. And so all those balances are growing, loan balances and deposit balances are all driven by having more sales capabilities.

And so, unless you assume your team isn't working hard, which is absolutely not the truth at Bank of America, the team works very hard, you've got to add more capacity to serve the customers. And we have tremendous opportunity, so whatever metric and you can stun yourself with the opportunity, the number of customers who have their banking accounts that are in wealth management business at other banks, hundreds of billions of dollars of bank deposit balances and loan balances, the amount of middle market investment banking goes to competitors from our middle market clients is 70%, 80% of their activity, which we should be capturing a lot more of. So we added middle market investment bankers.

So, that capacity is a requirement and we look at all the markets, 19 markets in the U.S. We look at the relative market shares. We look at what we should be able to do. We look at how the team works together, and we deploy those people in unison between five or six core business (01:16:25) markets to make sure we're building market so they can play off each other. And then they work to get business together and refer business back and forth. So without that sales force build, you won't have growth in the future.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Great. Thanks.

Operator

Thank you. We'll to go next to the line of Ken Usdin from Jefferies. Please go ahead.

Q - Ken Usdin {BIO 3363625 <GO>}

Thanks. Good morning.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Morning.

Q - Ken Usdin {BIO 3363625 <GO>}

Paul, I wanted to follow up on consumer credit. There's been last day or so a lot of concern about card. Your card losses have been up a little bit but very manageable, but I did notice you did – and you mentioned you've built the card reserve to now 3.5%. I'm just wondering what kind of normalization are you expecting on the card losses to follow – to start, sorry.

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yes. So we've been growing our card book. We have a back book that is well seasoned. We have a front book that we're growing, and that is seasoning like any other normal (01:17:22) card and you're seeing, I think, that across the industry. So we feel really very good about our card portfolio. We're focused on, again, prime and super prime. We're focused on our customers. We did see a modest pickup in NCOs year-over-year, but that was fully expected and planned for. So nothing here from our perspective, unusual.

Q - Ken Usdin {BIO 3363625 <GO>}

Okay. So just expected gradual seasoning? And you're not expecting any kind of vintage major shift in the recent growth?

A - Brian T. Moynihan {BIO 1517608 <GO>}

No. If you think about the whole card business as we reshaped it over the last 10 years, quite frankly, has been a move to more and more relationship customers whose credit statistics are relatively consistent over time. And so, while we have a year-over-year increase in card charge-offs, linked quarter it fell back down. And so you should expect this thing to bounce around in these rates, but it's because of the nature of the way we originate the cards with core relationship customers.

And then our focus is not necessarily getting a lot more cards out there, it's really get people to use their card as a primary card out of their wallet, the Bank of America customer, the Bank of America card, and using it, and that's where we're driving the business. So I don't think you'd expect – the strategy is responsible growth. So the balances grow a billion to a couple billion here over the last year, but it's going to be steady as you go and drive it. So you shouldn't see major changes in terms of nominal dollars of charge-offs.

Q - Ken Usdin {BIO 3363625 <GO>}

Understood. And then as a follow-up to that, in terms of the new Preferred Rewards card, how will that work through? Will there be any type of amortization of rewards cost, et cetera, that we should think about in terms of the card fees line? Or is that just also kind of already been in as part of the spending you've been doing?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Yes. So let me just take a step back, there's lot of people on the call and just review what we did. So we did launch it last month. It's a card that we launched because we were listening to our customers, and we wanted to design a card that rewarded them, rewarded those customers who wanted to deepen their relationship with us even further. And importantly, we also wanted to give them the flexibility to use their rewards the way they wanted to use them.

Similar to all our other cards, we are very careful to balance the customer value with the shareholder value, rewards that are very clear and transparent. We've got an upfront fee on this card that we're not waiving. So we've been very mindful of the profitability of the product and we don't expect any significant impact at this point anyways. We'll see how it goes, but at this point, any significant impact to card income from existing upfront.

Q - Ken Usdin {BIO 3363625 <GO>}

Okay. Thanks a lot, Paul.

Operator

Thank you. We'll go next to the line of Jim Mitchell with Buckingham Research.

Q - James Mitchell {BIO 1972127 <GO>}

Hey. Good morning.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Hey, Jim.

Q - James Mitchell {BIO 1972127 <GO>}

Maybe a quick question on rate sensitivity. It looks like it didn't change despite absorbing another rate hike this past quarter. Is that sort of indication that you've gotten slightly more asset-sensitive as the quarter went on? Or how do we think about the flat rate sensitivity?

A - Paul M. Donofrio {BIO 1533743 <GO>}

I mean, if you look at rates at the end of last quarter and you look at rates where they are now, there really hasn't been a lot of change. So it's the rate structure both existing at the end of the quarter versus existing then, plus what the forward path looked like at both those points, that drives that asset sensitivity disclosure and they were kind of similar at both points.

Q - James Mitchell {BIO 1972127 <GO>}

Was there any change in the short- versus long-end sensitivity?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Not really. It's still around two-thirds short end.

Q - James Mitchell {BIO 1972127 <GO>}

Okay. And maybe just a broader question on consumer credit. I mean I think that's been a big issue. I heard your comment on cards, but maybe just taking – looking at the consumer as a whole, do you feel like there's any stress points out there that gives you some pause? I think that's really what's going on in the industry, or at least in a lot of investor's minds, worrying about is this the start of a new upward cycle in consumer credit costs? And how do you think about that?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Look, again, we're focused on prime, super-prime, we're focused on our customers, and we're just not seeing it in that group. I'm looking at a page here. It's got residential on it and, after you adjust for the OCC bankruptcy and the repossession, if you look at card, if you look at auto, if you look at consumer vehicle lending, and you make an appropriate adjustment, net charge-offs, they haven't really gone up linked quarter or versus Q1. So we're just not seeing it yet in our net charge-offs.

Q - James Mitchell {BIO 1972127 <GO>}

Is there any reason...?

A - Brian T. Moynihan {BIO 1517608 <GO>}

That's a multiyear discipline. This is not something that happened this quarter. This is multi years of changing the underwriting standards and sticking to it and not bearing those standards as we move through time. So we change the mortgage underwriting standards in 2007 and 2008. We changed the card standards about the same time which the auto standards have always been high and we've always made that a business that we took very little credit risk in. And so when you think about it, we just don't see it but a lot of it's just sticking to the knitting over the years and to the responsible growth strategy and the team finding the growth in the customers. And so the debate's always been can you grow and the answer is yes but you've got to grow in a rational responsible basis and that's what's playing out this quarter relative to other people I think.

Q - James Mitchell {BIO 1972127 <GO>}

Okay. Great. Thanks.

Operator

Thank you. We'll go next to the line of Gerard Cassidy with RBC.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Good morning, Gerard.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Hi, Brian. How are you?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Good

Q - Gerard Cassidy {BIO 1505265 <GO>}

You mentioned, Brian, on the call about going into different markets with de novo expansion of your retail branches. Can you give us some color on how long it takes to get to those branches to breakeven? And then second, how long does it take to get them to a level of profitability that's similar to your legacy branches?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Well, I think it takes a while to build them up to the level of deposits, obviously, but what we've seen so far and that's going to be one of the things you test every quarter is some of the branches we opened in Denver quickly moves into the top 10% of sales and stuff. Now, why is that different than do novo branching? A, we have a nationwide brand; B, we have wealth management and commercial businesses in all these markets; C, we have card customers and mortgage customers in these markets that we've had for years. And so a lot of times you're converting a deepening proposition as opposed to I'm opening a store and seeing what comes in.

And the fourth is we're strategically located near the rest of our teammates are and drive it. So they're getting up to speed faster. I won't give you the exact date that we target and things like that because its proprietary but you should assume that they're getting up to speed faster and you should assume that we're smart enough that we're not going to build them if they don't work.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Very good. And then second, we're all familiar with the treasury white papers that have come out about where they think regulation should go for the banks. When you guys review what has come out, what are the top one, two or three items that when you sit down with the new Vice Chairman of the Fed, Quarles, what you're going to talk to him about? And as part of that answer, can you share with us your thinking on where's your operational RWA? And is that a big issue for you to talk to the regulators about changing in the future?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Sure. So on the first point on the white papers and all the other stuff that you've been seeing, look, as an industry, I think it goes without saying that we really have a vested interest in reasonable regulation but it also promotes safety and soundness. So we are very focused on that. I would say that we are for regulatory refinement that promotes economic growth while protecting financial stability. There's been a lot of discussion out there, a lot of white papers. There's lots of great points that are being made in those papers. But we would be in favor generally in the type of refinement that allows us more access and control over our capital and liquidity in support of responsible growth that we've been talking about all throughout this call, in support of the economy and the communities where we live and work, and for lending and for capital return.

We've talked about how large our buffer is. We'd also like to see a little bit more efficient regulation driven by harmonization across the regulatory bodies. So we're going to work with whatever parties we can to see some of this get refined in a responsible way.

And your second question was on RWA – oh, on operational risk capital, yes, one of our favorite subjects. Yes, look, we have a third of our advanced RWA is operational risk RWA. It's a floor that's been given to us by regulators. That $500 billion is 33% more than our next closest competitor has in operational risk RWA. That $500 billion is more RWA than just about all the European banks have in total RWA. So we'd like to make progress on that. The advanced approach is something we use to manage risk at the company so it's important to have an accurate amount of RWA as we think about how we're managing the company.

Having said all that, I would point out that, at least in the United States with the Collins Amendment, we have to have an amount of RWA that is the higher of standardized and advanced. And as we continue to make progress on optimizing how we deliver for customers and clients, we are optimizing our advanced RWA and it's getting closer and closer to standardized. So at some point, standardized will likely become our binding constraint. That doesn't mean that the operational risk capital is not operational or it is not important. It is, but standardized at some point will become our binding constraint and make that a little bit moot.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Very good. And then just finally, Paul, you mentioned, I think, on the call about the higher rep-and-warranty expense. Can you guys kind of frame for us what's left there? And do you – obviously, I'm assuming we're toward the tail end, but do you guys know about what's left?

A - Paul M. Donofrio {BIO 1533743 <GO>}

Look, we don't really go through them line by line. I think you guys know all the big ones. I'll be happy to sort of list a couple of those, if you want. What I would say is, if you look at our disclosures, we still have $2 billion in reserves for reps and warranties and we've got another $2 billion, at least as of the end of the second quarter, in the RPL for reps and warranties. So we're going to work through these things and we're going to see over time how that all plays out.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Very good. Brian, we'll see you in Boston. Thank you.

Operator

Thank you. We'll take our final question from the line of Saul Martinez from UBS. Please go ahead.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. Thanks for taking my question. Want to ask about a follow-up on efficiency and cost performance beyond 2018 and where you think your efficiency ratio can go to. So you've obviously brought down your efficiency ratio to 60%. If you get to the $53 billion, whenever that is, 2018 or whenever you get there, around 2018, you drive down your efficiency ratio even further to, say, 57%, 58%, so you're pretty close to sort of your competitors despite the fact that your business mix is one that has more wealth management and which has a higher efficiency ratio.

So how should we think about your ability, the opportunity set, to continue to drive positive operating leverage over a multiyear period and get your efficiency ratio down even further to the mid- to low-50% range? And I know it's a difficult question to answer and it depends on a lot of things, but with technology and AI and cognitive computing and digitization and mobile banking, can we see efficiency ratios that maybe a few years ago we wouldn't have even thought about for a bank like Bank of America?

A - Brian T. Moynihan {BIO 1517608 <GO>}

Well, I think a number of things. Number one, you've got the general picture right, which is we're getting it down to $53 billion. That puts us in a level. We have a higher position of wealth management which has revenue-related compensation that, obviously, is a 27% pre-tax margin. You flip that around to 83% efficiency ratio and it's a meaningful amount of dollars, but it's a great return on capital business and the last thing you want to do is not grow it. So that creates a dynamic around the aggregation of all these numbers. And you look at the other ones and they're 50-ish type of numbers across the board.

So we're going to drive that. When you think about in the future, the way we talk about it is the $53 billion is the 2018 target. We try to hold it flattish after that, fighting to apply technology, all things you talked about, more digitization, and the earlier questioners talked about using that to offset the fact that medical care premiums go up 6%, 7%, something else goes up, the rents go up, and things like that, and pay for all that: merit increases and bigger bonus pools because our teammates are doing a good job.

So all that, you're fighting that, and if you keep it flattish and then the question what scenario you're playing into. If your rates rise a little bit, that pores the bottom line and that's what we told you guys before and that's what we'll tell you in the future. There's no additional cost to that. If it comes through wealth management fee generation, it's going to have more expense attached to it. So it's a little bit of what scenario we're playing into, but we don't target – the efficiency ratio is a result of all the hard work that goes in to keep expenses flat, down to $53 billion and flattish after that.

That will then produce an efficiency ratio base little bit on the revenue scenario, which could be a little on the economics and what's going on out there, but you should rest assured after $20 billion expenses in the last five years taken out of this company that there's no team that is more focused on this than the team that works for me.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Great. That's very helpful. Thanks a lot.

A - Brian T. Moynihan {BIO 1517608 <GO>}

That was the last one? Okay.

Operator

We would like to turn it back over to Mr. Moynihan for closing remarks.

A - Brian T. Moynihan {BIO 1517608 <GO>}

Thank you, operator. Let me just wrap up quickly. Thank you all for being on the call today and thank you and look forward to talking to you next quarter. As you think about Bank of America over the quarter three of 2017, it's pretty straightforward: responsible growth. It's evidenced across the company in all different fashions, whether we've got to grow, no excuses. You saw that in balances and revenue. Got to do it with the right customer focus, got to do it with the right risk, and we got to do it and be sustainable.

And we say sustainable, that means we got to do it and keep investing in the future, and you saw us do that also. When we do that right, we can take more capital and deliver it back to you through dividends and share buybacks and, as we told you earlier, we've nearly doubled that year-over-year. So thank you and we look forward to talking to you next quarter.

Operator

I'd like to thank everybody for their participation. Please feel free to disconnect at any time.
