Q1 2017 Earnings Call

Company Participants

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

Other Participants

- Andrew Lim, Analyst
- Brian Kleinhanzl, Analyst
- Elizabeth Lynn Graseck, Analyst
- Gerard Cassidy, Analyst
- Glenn Schorr, Analyst
- John Eamon McDonald, Analyst
- Ken Usdin, Analyst
- Marty Mosby, Analyst
- Matt O'Connor, Analyst
- Saul Martinez, Analyst
- Steven Chubak, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, everyone, and welcome to today's Bank of America First Quarter Earnings Announcement Conference Call. Please note this call may be recorded. It is now my pleasure to turn today's program over to Mr. Lee McEntire. Please go ahead, sir.

Lee McEntire {BIO 6651246 <GO>}

Thank you. Good morning. Thanks to everybody for joining us this morning for the first quarter 2017 results. Hopefully, everybody's had a chance to review our earnings release documents that were available on our website. Before I turn the call over to Brian and Paul, let me remind you we may make some forward-looking statements. For further information on those, please refer to either our earnings release documents, our website or our SEC filings.

With that, I'm pleased to turn it over to Brian Moynihan, our Chairman and CEO, for some opening comments before Paul Donofrio, our CFO, goes through the details. Take it away, Brian.

Brian T. Moynihan {BIO 1517608 <GO>}

Thank you, Lee, and good morning, everyone, and thank you for joining our first quarter results.

I'm going to begin on slide two, and first, this quarter is another solid example of driving responsible growth at Bank of America. My teammates continue to deliver for customers around the world, and not many companies have the sources we have to help our clients drive the global economy. But with that, we understand that responsibility comes with doing this, and we do it in a responsible way. Responsible growth is driving more sustainable returns for you as shareholders also.

This quarter, we produced strong revenue growth. We drove cost savings that offset higher revenue-related cost, and we managed risk well, and we returned more capital to you, our shareholders, through dividends and increased repurchase of shares than any period since the crisis.

Turning to slide three. Our company produced earnings of $4.9 billion after-tax in the first quarter of 2017. Those earnings were up 40% compared to the first quarter of last year, driven by 700 basis points of operating leverage. Revenue rose 7%, and we managed to keep overall expenses flat.

Our earnings per share were $0.41 per share. On a diluted basis, that was up 46%. This is the fourth quarter in a row we've exceeded $0.40 of EPS per share. We did that in quarter one despite $1.4 billion of annual retirement-eligible incentives and seasonally elevated payroll tax costs. And importantly, we have done this in a responsible manner, not reaching for growth outside of our established risk and customer framework. And we achieved this in an economy which continues to grow in the 1.5% to 2% range.

On a year-over-year basis, our average deposits were up over $58 billion. Average loans were up $21 billion, and sales and traded revenues, excluding DVA, were up 23% with better client activity. We saw $29 billion in long-term assets under management flows this quarter within our wealth management business.

Asset quality remained strong with provision expense of $835 million. Net charge-offs were down 13% from the first quarter of 2016 but were modestly up from the fourth quarter 2016 as expected from the normal seasonality, especially in consumer credit cards.

Regarding progress against long-term metrics, the first task the company had many years ago was to become stabilized, then it was to reduce our legacy costs and simplify the place, and then we drove towards sustainably of results. Once results became more sustainable, we pushed towards generating return on tangible common equity above our cost of capital. We now have shown that we have a return on tangible common equity in the double digits for last 4 quarters. And keep in mind that we have been doing this where our capital continues to build. The next step is to push that towards our 12% target.

This quarter, our return on tangible common equity was 10% where return on assets was 88 basis points. These are reported numbers. The efficiency ratio was 67%. These figures reflect solid progress in this quarter against our long-term targets but are even closer if you were to allocate the seasonal aspects of the retirement-eligible compensation cost and elevated payroll tax expenses across the years as just opposed to putting it all in the first quarter.

And even though quarter one is typically a good capital markets quarter for us, if you just spread those costs, you'll see that across all the quarters, the metrics this quarter would have been reflected in efficiency ratio of near 62%, a return on assets of nearly 100 basis points and a return on tangible common equity of 12%. So simply put, we're getting there.

On slide four, as I mentioned, the key to profitability in this environment is to drive good core customer growth and revenue while controlling our cost to drive operating leverage. We have established record for the past several years of producing quarterly operating leverage on a year-over-year basis.

This quarter, you can see on the slide 4, that our revenue growth on a year-over-year basis across each of our business segments. We're also able to hold the expenses overall in the company flat through the careful management of costs. As you can see on this slide, there's 700 basis points of operate leverage for the total company.

Some of our businesses like our Consumer business have been driving operating leverage consistently for many years in a row now. Some, like our Global Banking business, are using operating leverage to drive the company to the best line of business efficiency ratio among our businesses.

Other businesses continue to have leverage opportunities are becoming more clear. This is the case in our wealth management or our Global Markets businesses.

As we turn to slide five, you can see the line of business results. Each business improved their efficiency ratios. Each line of business reported returns well above the firm's cost of capital. Consumer Banking continued its strong performance and transformation, produced $1.9 billion in after-tax earnings this quarter, growing 7%. And on a pre-tax, pre-provision basis, PPNR, which excludes the prior year's sizable reserve release, the PPNR was up 17% year-over-year. The efficiency ratio in this business was down 500 basis points to 53%.

Global Wealth and Investment Management improved earnings 4%, earning $770 million after-tax, improving its profit margin to 27%. This is a new record for the business.

Our Global Banking business produced a record revenue quarter led by strong investment banking results, and that generated $1.7 billion in after-tax earnings. It remains our most efficient operating business at 44%.

Lastly, our Global Markets business earned $1.3 billion in after-tax earning, generating a 15% return on its allocated capital. Improved performance in sales and trading revenue combined with strong expense discipline drove those results. All Other categories shows a loss, driven mostly by the $1 billion in first quarter FAS 123 cost and related personnel taxes, which gets allocated across the business segments throughout the year. But the reduction in losses year-over-year was driven by improved operating costs in the company and lower litigation expense.

As you'll see from the slides Paul will walk you through later, our business have important leadership positions across the board. We believe they have room to grow both market share by deepening relationships with existing customers and by winning customers from the competition. Overall, I'm pleased with the results this quarter. We grew the top line, we grew the bottom line, and we did it the right way, all while making significant investments in people, technology, more capabilities for our customers. And all that will bode well for future growth.

While many of you might focus on rates and our leverage to rising rates, note that the $1.5 billion in year-over-year revenue growth is split 40% for NII, which is driven by rates and by also the growth in loan and deposit balances. And the other 60% was driven through non-interest revenue.

As you know, we remain focused on things we know we can control and drive. We maintain our discipline on both expenses and pricing. Our rates paid has remained steady at nine basis points on deposits while, at the same time, we have grown those deposits 5% year-over-year, $58 billion.

On lending activity there's been a lot of discussion regarding a slowdown. In our core middle market business, representing a broad base of American companies, our business loans grew 7% year-over-year. In our smaller business segments, business banking and small business, we're up 3%, and small business had the best production quarter in its history.

We assisted our Markets clients with their financing needs, which also put capital in the system for economic growth. All this growth occurred in a sub-2% GDP growth environment. Our clients stand ready, they're engaged, and they're ready to grow faster as the economy continues to grow and improve.

Now let me turn it over to Paul to go through the other details about the quarter. Paul?

Paul M. Donofrio {BIO 1533743 <GO>}

Thanks, Brian.

I will start with the balance sheet on page six. Overall, end-of-period assets increased $60 billion from Q4. The growth was fairly evenly split between two elements: first, we saw higher trading-related assets in Global Markets business with incremental customer activity following a seasonal slowdown at the end of Q4; secondly, we had higher cash levels driven by seasonal deposit growth, primarily from tax refunds. Deposits rose $55 billion or 5% from Q1 2016 and are up $11 billion from Q4. Q1 deposit growth was primarily driven by customer tax refunds in our Consumer business.

Loans on end-of-period basis were steady with Q4 as solid Commercial growth was offset by seasonal declines in credit card and runoff of legacy non-core loans. Lastly, common equity increased $1.3 billion compared to Q4 as $4.4 billion in net income available to common was reduced by $3 billion and capital returned to shareholders through dividends and net share repurchases.

Global liquidity sources increased in the quarter, driven by higher deposit flows and bank funding. We remain well compliant with fully phased-in U.S. LCR requirements. Book value per share rose 5% from Q1 2016 to $24.36.

Turning to regulatory metrics and focusing on the advanced approach. Our CET1 transition ratio under Basel III ended the quarter at 11%. On a fully phased-in basis, compared to Q4, the CET1 ratio improved 20 basis points to 11% and remains well above our 2019 requirement of 9.5%. CET1 capital increased $1.6 billion to $164 billion, driven by earnings and the utilization of deferred tax assets offset by return of capital. The ratio also benefited from a $14 billion decline in RWA, driven by lower exposure in our Global Markets business, lower card exposure and a legacy asset runoff.

We also provide our capital metrics under the standardized approach, which remains relevant for CCAR comparison purposes. Here, our CET1 ratio is 10 basis points higher at 11.6%. Supplementing leverage ratios both for parent and bank continue to exceed U.S. regulatory minimums that take effect in 2018.

Turning to slide seven and on an average basis total loans were up $21 billion or 2% from Q1 2016. Loan growth in our business segments was primarily offset by continued runoff in non-core consumer real estate loans in All Other. Year-over-year loans in All Other were down $23 billion. On the other hand, loans in our business segments were up $44 billion or 6%.

Consumer Banking led with 8% growth. We continue to see good growth in residential mortgages although originations slowed in Q1 2017, given the increase in mortgage rates in Q4 and Q1. We saw growth in credit card and vehicle loans. Home equity pay-downs continue to outpace originations. In wealth management, we saw a year-over-year growth of 7%, driven by residential mortgages. Global Banking loans were up 4% year-over-year.

Loans in our Commercial business grew 6% year-over-year despite a slight reduction in commercial real estate. We think these growth rates are responsible given the economy grew around 2% year-over-year. Middle market revolver utilization rates have now climbed back to record levels. On the bottom of the chart, note the $58 billion, 5% year-over-year growth in average deposits, which is driven by 10% growth in Consumer Banking.

Turning to asset quality on slide eight. The stability of our asset quality and loss trends reflects many years now of disciplined client selection and strong underwriting practices that are foundational to our responsible growth and through-the-cycle performance. Credit quality remains strong. Total net charge-off of $934 million or 42 basis points on average loans increased slightly from Q4 due to expected seasonality in our credit card products, but were down 13% from Q1 2016.

Provision expense of $835 million rose $61 million from Q4 but was down $162 million from Q1 2016. Net reserve releases in the quarter of $99 million was fairly consistent with Q4 and the year-ago quarter. Note that Q1 2016 included a significant increase in reserves in Global Banking for energy exposures. That was mostly offset by releases in consumer reserves in that quarter. Our reserve coverage remains strong with an allowance-to-loan ratio of 125 basis points and a coverage level three times our annual charge-offs. NPLs and reservable criticized exposure both declined notably.

On slide nine, we break out credit quality metrics for both our Consumer and Commercial portfolios. On the Consumer chart, you can see the impact of the seasonal increase in credit card losses. Note that delinquency trends remain low and improved modestly from Q4. Commercial losses continue to be low.

Turning to slide 10. Net interest income on a GAAP non-FTE basis was $11.1 billion, $11.3 billion on an FTE basis. NII improved $730 million from Q4, primarily due to higher rates. The net interest yield increased 16 basis points to 2.39% from Q4 as loan yields improved 17% while the rates we paid on deposits was flat at nine basis points. Q4 and Q1 increases in long-end interest rates resulted in slower prepaids and less premium amortization on our securities portfolio this quarter. Increases in the short end in terms of interest rates caused our variable rate assets to reprice higher while we maintained good pricing discipline on deposits. We also benefited from normal seasonality in Q1 in our leasing business. And in addition, we benefited from less unfavorable hedge ineffectiveness as compared to Q4. But one can think of the reduction in the hedge ineffectiveness as roughly offset by two fewer days in the quarter.

Now as Brian mentioned, we remain disciplined around deposit pricing given the investment we have made in customer relationships through Preferred Rewards and other deepening activities. So your natural next question is what should shareholders expect for Q2 with respect to NII given the March rate hike by the Fed? Based on our models and assumptions, we believe NII should continue to improve, but the improvement is expected to be much more modest than Q4 to Q1 driven by a number of factors, most notably, the increase in long-term rates in Q1, in Q4 and Q1 drove a significant portion of the Q1 improvement.

In terms of Q2, think about it this way. Given where we are today, with the Fed funds rate hike in March and the long end down since the end of the first quarter, I would focus you on our asset sensitivity disclosures. As of 3/31, an instantaneous 100 basis point parallel increase in rates is estimated to increase NII by $3.3 billion over the subsequent 12 months, which is consistent with our position at year-end. Nearly three quarters or $2.5 billion of this modeling is driven by our sensitivity to short-end rates. Given a one month LIBOR rise of about 25 basis points with the March hike and the long end down, we should focus on the $2.5 billion short-end benefit. Dividing that by 4 gets you to a quarterly run rate of roughly $600 million for a 100-basis point shock. Assuming it's only 25 basis points instead of 100 would get you to approximately $150 million benefit in the quarter. From there, we would expect continued modest growth in NII in the second half of 2017 assuming modest growth in loans and deposits and rates at least above where they are today.

Turning to slide 11. Non-interest expense was $14.8 billion. We were able to hold expense flat compared to Q1 2016 despite 9% growth in non-interest income and several other expense headwinds. The efficiency ratio improved 400 basis points year-over-year. And if you allocate Q1's $1.4 billion of incentive for retirement-eligible employees and the seasonally elevated payroll tax across all four quarters, then the efficiency ratio would be 62%.

Our company-wide simplification efforts and the $110 million in lower litigation cost offset a number of higher expenses year-over-year, including $150 million of higher incentives for annual retirement-eligible employees and seasonally elevated payroll taxes; $190 million of higher incentives associated with revenue growth across wealth management, Global Banking and Global Markets; and $160 million of higher expenses due to changes in our share price with respect to accounting for employee stock-based awards. The year-over-year swing is caused by the share price decline in Q1 2016 compared to an increase in Q1 2017. We also had $100 million in higher quarterly cost for FDIC assessments. Finally, note that employees are down 2% from Q1 2016, and we continue to add client-facing associates.

Turning to the business segments and starting with Consumer Banking on slide 12. Consumer Banking had another solid quarter. This segment produced $1.9 billion in earnings, growing 7% year-over-year and returning 21% on allocated capital. Note that that 21% return is on $37 billion of allocated capital, which is an increase of $3 billion this quarter given growth in their loans and deposits.

On a pre-tax pre-provision basis, which adjusts for the sizable release of reserves in Q1 2016, earnings rose $559 million or 17%. Year-over-year, average loans grew 8%. Average deposits grew 10%, and Merrill Edge brokerage assets grew 21%. That drove revenue growth of 5% led by a 9% increase in NII from Q1 2016. Note that the rate paid on deposits in this business declined 1 basis point year-over-year to 3 basis points as a result of disciplined pricing.

Non-interest income included improvements in service charges and a small increase in card income that was more than offset by decline in mortgage banking income. The decline in mortgage banking income was due to both lower volumes from less refinancings as well as our strategy of holding more of our production on our balance sheet versus selling it to the agencies. Through continued efforts to drive down costs, the efficiency ratio improved nearly 500 basis points to 53%. Cost reductions also helped drive the cost of deposits down 10 basis points from Q1 2016.

Consumer Banking credit quality remained solid, with the net charge-off ratio declining 4 basis points to 121 basis points.

Turning to slide 13 and looking at key trends. First, as usual, on the upper left, the statutory reminder of our strong competitive position. Second, as we point out each quarter, while we report NII and non-interest income separately, our strategy remains focused on relationship deepening and growing total revenue while improving operating leverage through expense discipline.

So as you review the top boxes on this page, note that we drove 8% operating leverage this quarter. Also, note that our relationship deepening is improving NII and balance growth, while holding fee line flat as we reward customers for doing more business with us.

Average deposits continued their strong growth, up $57 billion or 10% year-over-year, outpacing the industry. Importantly 50% of these deposits are checking accounts, and we estimate that 89% of these checking accounts are the primary accounts of households. This means these are operational accounts used to pay mortgages and car payments and other bills, so outflows chasing rates is less likely in our view. We also believe these deposit accounts offer clients significant value in terms of transparency, convenience and safety, which also means they are less likely to move their relationships.

With respect to card, spending levels and new issuances were solid. However, the industry's trend of increasing rewards continues to mitigate our overall card revenue growth. Digitalization and other productivity improvements as well as lower fraud costs continue to lead expenses lower. Expenses declined 3% from Q1 2016 despite increases in the FDIC assessment rate and charges. Focusing on client balances on the bottom left, you can see the success we continue to have growing deposits, loans and brokerage assets.

Merrill Edge continues to attract customers who want a self-service investment option as accounts are up 11% from Q1 2016. We now have more than 1.7 million households that leverage our Financial Solution Advisors and self-directed investment platform. This quarter also included the successful rollout of Merrill Edge Guided Investing for clients who want some advice from our CAO office but don't desire a fully advise relationship.

With respect to loans, residential mortgages continue to lead our growth. As expected, the sudden rise in long-term rates in late 2016 caused a noticeable decline in mortgage production from Q1. While mortgage originations was down, we continue to hold more of our loans on the balance sheet. In Q1, we retained about 80% of first mortgage production on the balance sheet. We believe retaining these mortgages will provide better economics over time, plus retention deepens our relationship with these customers.

Consumer vehicle lending remained solid, up 12% year-over-year, and we continue to remain focused on prime and super-prime borrowers. Our net charge-offs at 38 basis points remain not only low, but also lowest among peers. U.S. consumer card average balances grew 3% year-over-year, and spending on our credit cards was up 8% compared to Q1 2016.

Turning to slide 14, we remain a leader in digital banking. And we continue to see momentum in digital banking adoption. Given the rollout of Zelle this quarter, Bank of America customers can now use their online app to transfer money, request money and split bills person to person with more ease than before.

While still in its infancy, customers sent $8 billion in payments through our person to person apps in Q1, which is up 25% year-over-year. Importantly, as digital banking adoption rises, particularly around transaction processing and self-service, we expect to see continued improved efficiency and customer satisfaction.

Mobile devices now account for one out of every five deposit transactions and represent the volume of nearly 1,000 financial centers. Sales on digital devices continue to grow and now represent 22% of total sales. Still, with all the digital activity, we have not forgotten and remain focused on the 800,000 people walking into our financial centers across the U.S. on a daily basis.

Many of these customers still use our branches to transact, but many others use our branches as financial destinations, where they can learn more about products and services, work face to face with a specialized professional and generally improve their financial lives. We want to encourage that, and that's why we have an extensive branch refurbishing underway. By the way, that's also helping increase customer satisfaction.

We're also building new centers in markets where we have never had financial centers but where we have presence across Global Banking, wealth management or both. These markets include MSAs like Denver, Minneapolis and Indianapolis. In addition, we are testing smart centers, which utilize video-assisted ATMs and other video (27:49) conferencing capabilities in regions where it makes sense.

Turning to slide 15, let's review Global Wealth and Investment Management, which produced earnings of $770 million and record pre-tax operating margin of 27% while returning 22% on allocated capital. These solid results were produced in a period of change for the industry as firms and clients anticipate new fiduciary standards and other market dynamics such as the shift between active and passive investing.

Net interest income rose 3%, driven by loan growth. Year-over-year, non-interest income also rose 3% as 8% higher asset management fees were partially offset by lower transactional revenue. Year-over-year, while total revenue grew 3%, expenses grew 2%, creating an important but modest operating leverage. Also, note the $29 billion of long-term AUM flows this quarter, reflecting strong client activity as well as the continuing shift from IRA brokerage to AUM.

Moving to slide 16. We continue to see overall solid client engagement. Client balances climbed to nearly $2.6 trillion, driven by higher market values, solid long-term AUM flows and continued loan growth. Average deposits of $257 billion were flat compared to Q4, while ending deposits were down, primarily reflecting some movement to investment assets. Average loans of $148 billion were up 7% year-over-year. Loan growth remains concentrated in consumer real estate.

Turning to slide 17, Global Banking had record revenue this quarter, up 11% year-over-year led by investment banking activity. Revenue growth coupled with expense management improved the efficiency ratio 500 basis points to 44%.

In addition, provision expense of $17 million in Q1 2017 was more closely aligned with charge-offs, while Q1 2016 included approximately $500 million in reserve increases for energy exposure. This resulted in a 58% year-over-year improvement in earnings to $1.7 billion.

Global Banking continues to drive loan growth within its risk and client frameworks, albeit at a slower pace. Total investment banking fees for the company were $1.6 billion, which was up a 37% from Q1 2016. By comparison, overall industry fee pools were up 19% year-over-year.

A number of items to note, given the strong performance. First, this was a record Q1 in terms of revenue from IB fees. Client underwriting activity in the capital markets was quite strong. We also earned record M&A fees this quarter with involvement in six of the top ten completed transactions.

Debt underwriting was up 38% year-over-year, led by strong performance in leveraged finance. Equity underwriting was up 65% year-over-year. Expenses decreased from Q1 2016, despite higher revenue related incentives, higher FDIC insurance costs and costs associated with adding 340 new relationship managers over the past couple of years. Return on allocated capital increased to 18% despite adding $3 billion of allocated capital this quarter.

Looking at trends on slide 18 and comparing to Q1 last year. Average loans were up $14 billion or 4%. Growth was driven by our commercial bank, where lending was up 6% despite subdued real estate lending. As Brian said, we feel good about this growth rate given 2% GDP environment.

We stand ready to support clients who want to borrow directly from us or tap the capital markets. One of the benefits of our universal banking model is our ability to deliver for clients across a complete product set and geographies. Average deposits increased 2% from Q1 2016. As expected, we saw a seasonal decline in deposits from Q4. We remain mindful of LCR rules as we grow deposits.

Switching to Global Markets on slide 19. The business had a strong quarter, which, once again, benefited from the breadth of our product and geographic footprint with leadership positions in a number of areas. This quarter saw strong issuer activity and tighter spreads across credit products, which played well to our strength in mortgage and corporate credit. The business improved operating leverage with revenue, excluding

DVA, growing 27% while expenses increased modestly after adjusting for litigation recovery in Q1 2016.

Global Markets earned $1.3 billion and returned 15% on allocated capital. This includes a reduction of capital of $2 billion, given the great work the team has done optimizing the balance sheet and reducing RWA in the past year.

It is worth noting that we achieved these results with a lower VaR and 6% fewer people than last year. With respect to expenses, Q1 2016 litigation included a sizable litigation recovery. Excluding litigation, year-over-year expenses were up 2% while revenue grew 19%.

Moving to trends on slide 20 and focusing on the components of our sales and trading performance. Sales and trading revenue of $4 billion, excluding net DVA, was up 23% from Q1 2016. Excluding net DVA and versus Q1 2016, FICC sales and trading of $2.9 billion increased 29%. Within FICC, the year-over-year improvement was driven by improved client activity and corporate credit and mortgage products.

Equity sales and trading was up 7% year-over-year to $1.1 billion, despite weaker cash equity volumes. We saw increased activity in Europe and Asia across all products. We also are beginning to see the benefits of deploying additional balance sheet to meet the financing needs of clients.

On slide 21, we show All Other, which reported a net loss of $834 million. This was an improvement from Q1 2016, driven by lower litigation and mortgage servicing costs. The only other thing worth pointing out here is a reminder that this is where we book the annual retirement eligible incentive and elevated Q1 payroll tax before they get allocated out to a line of business throughout the year.

The effective tax rate for the quarter was 26% and included approximately $200 million of tax benefit from the deductions on deliveries of share-based awards exceeding the related compensation costs. A recent change in accounting rules requires booking this difference to the tax income expense instead of directly to equity. The effective tax rate would have been 29.4% excluding this benefit, which is in line with our expectation of approximately 30% for the rest of the year.

Okay. A few summary points as I wrap up. This quarter shows the value of our businesses as rates begin to rise and as we experience increased capital markets activity. For years, we have stayed focus on growing responsibly, including staying within our risk and client frameworks and making our growth more sustainable by simplifying the company and improving efficiency.

In Q1, consistent with this strategy, we stuck to our strong underwriting standards while growing loans and trading assets. Asset quality remains strong, and net charge-offs low. We grew deposits while managing deposit rate paid. We grew AUM while helping clients adapt to a changing industry. When client activity picked up, we were ready with a breadth of capabilities to raise capital and manage risk in major markets all around the world.

We continue to invest in new technology and capabilities while adding sales professionals in certain businesses. We lowered non-personnel expenses, offsetting some seasonal and other expense headwinds this quarter. We created operating leverage in each of our business segments, and we returned more capital to shareholders than in any quarter since the financial crisis.

These results tell us that responsible growth is working, with more to come as the economy continues to improve.

Many of you have been waiting patiently for us to approach our long-term targets. I hope you noted that, if one allocates annual retirement eligible incentives and seasonally elevated payroll tax throughout the year, we are basically at our return targets this quarter. We know we have more work to do to be consistently achieving all our targets, but we have more confidence than ever that responsible growth will get us there.

With that, we'll open it up to Q&A.

Q&A

Operator

And we'll take our first question from Glenn Schorr with Evercore ISI. Please go ahead, sir.

Q - Glenn Schorr {BIO 1881019 <GO>}

Hi. Thanks very much. First, a very quickie. Did you mention what NPLs you sold during the quarter and if there was any P&L impact?

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

Small and small. Small sales, small impact.

Q - Glenn Schorr {BIO 1881019 <GO>}

No problem. I'm curious. I think we've all taken note of the responsible growth, what you've done, heard your comments on it relative to the economy. I'm curious, as we watch the industry loan growth come down for a bunch of different reasons, can BofA continue on this path? I don't want to say irregardless of what the industry backdrop is, but can it buck the trend of the decline in loan growth that we're seeing in most other places?

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

Glenn, it's Brian. I think, at the end of the day, banks reflect the economy and help make the economy happen. So we've been able to grow loans 5%, 6% in the core middle market segment, 7% actually year-over-year. Credit cards been picking up a little bit, home equity strong, residential mortgage down. So if you look at it overall, we've been able to outgrow the economy, but we're going to be dependent upon the economy keep growing.

But what we've shown you across the last couple years, with the discipline we have for driving deeper penetration in our customers, working hard on our relationships even with the repositioning portfolios that you can see in some of the slides and/or making sure that we maintain great discipline, we'd be able to grow the mid-single digits as we've told you against the backdrop of an economy growing at 1.5% to 2%. If that goes faster, we'll grow faster. If that stays in that range, we should be able to continue to grow at that level.

Q - Glenn Schorr {BIO 1881019 <GO>}

Okay. Maybe on the credit front, as you've mentioned credit's awesome in most places, and I saw criticized credit came down with energy improving. Are there any areas that are criticized credits increasing like something like retail?

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

No. Credit looks good across the board, and it's performing as we model and expect.

Q - Glenn Schorr {BIO 1881019 <GO>}

Okay, last little one. Zelle, you mentioned the increase in Zelle activity. Do you make money on that, or is that mostly a customer retention tool?

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

I think, Glenn, think about it this way, is the way people pay each other. So you don't – we don't charge for it. It's just a service as part of a core DDA account just like checks or just like an ATM card would be to withdraw. It's just a more efficient for the customer, more efficient for us too, ultimately, because the payback will be taking cash out of the system.

And so year-to-date, we're up about – even before Zelle is announced for the first quarter P2P payments at Bank of America up 25% first quarter of 2017 versus first quarter 2016. So this is growing fast and will continue to grow. What we'll do a swap out other payment forms, which cost us more to execute, but it's free to the customer.

Q - Glenn Schorr {BIO 1881019 <GO>}

Great. Appreciate all the answers. Thanks.

Operator

And we'll take our next question from John McDonald from Bernstein. Please go ahead.

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

Good morning. Paul, just a clarification regarding the second quarter framework you provided for net interest income. Does the $150 million potential bump based on the disclosures include the benefit of loan growth or was that just the rate impact and could it be a little better if loan growth continues?

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

Well, the loan growth is embedded in our 100-basis-point shock. So, theoretically, it includes it. But if loan growth's a little bit better than we think, it could be better. If it's a little lower, it would be less. That's one of the variables that we have to think about when we think about NII growth.

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

Okay.

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

John, just one of the things to keep in mind there is, remember, we just capitalized or put in a run rate, for lack of a better term, $600 million plus fourth quarter to first quarter. And this is on top of that too. That first benefit as you think for the year, that benefit is now locked in and moves its way through the system.

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

Got it. So it's incremental to the 1Q print. Okay. And then can you remind us what kind of deposit repricing beta you assumed in the disclosures, Paul?

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

Sure. So on a 100-basis-point rise on interest-bearing deposits – and remember, we have a large amount of non-interest-bearing deposits. But on interest-bearing deposits, we're kind of low 50-ish for that full 100-basis-point rise.

As you can expect, the first 25, 50 of the 100 is going to be a little bit different than the second 25 or 50. And that's about as much that I want to give you, given the competitiveness around this topic.

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

Okay. A separate question on capital. With the CET1 at 11% now versus the 2019 requirement of 9.5%, what kind of buffers are you thinking of holding? And what level of CET1 feels right like the right target for you longer term?

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

So with respect to buffers, I wouldn't want to give an exact number for all sorts of reasons. We put a lot of thought into how we manage our capital and liability structure, including buffers. Having said that, we have 150 basis points of cushion right now on fully phased-in minimums and a lot of time between now and 2019. So maybe we'll talk more about it as we get a little closer. But right now, we feel good where we are.

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

Okay. Great. Thank you.

Operator

And we'll take our next question from Steven Chubak with Nomura Instinet. Please go ahead.

Q - Steven Chubak {BIO 18457976 <GO>}

Hi, good morning.

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

Morning.

Q - Steven Chubak {BIO 18457976 <GO>}

So just wanted to kick things off with a question on the 2018 expense target of $53 billion that you guys had outlined on previous calls. Can you just remind us what the revenue growth assumptions were underlining that target? And just given some of the acceleration that we've seen in fee income growth and the higher incentive comp, is that still an achievable target in your view?

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

The revenue growth assumptions were, like we said, long term we believe we can grow faster than GDP growth, and that's embedded in those assumptions. I think the way for you, Steve, to think about is, look at the Global Markets year-over-year and what you see there is with that substantial rise in revenue, the expense growth absent last year, we had a credit in litigation, this year we had an expense, so you had a pretty good reversal there.

Absent that, it was 2% growth. And as Paul said, had 6% less people. Comp expenses were up a bit, even though revenue was up quite a bit. So we can manage against that with the inevitable thing that if revenue grows faster, we might have a little bit more expense pressure. But I think we'll be very happy to see that happen.

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

Look, the only thing I would add for just for the record is when we gave that guidance around this time last year, we specifically said it was based upon the economic environment at that time and that if things got better, we'd have to adjust. If things got worse, we'd have to adjust.

Having said all that – that's just for the record – having said all that, we're still focused and confident we can get to the $53 billion – approximately $53 billion for full year 2018. That's what we said.

Q - Steven Chubak {BIO 18457976 <GO>}

Got it. And then just one question on the provision outlook. Just given the continued favorable credit and delinquency trends, how should we be thinking about the trajectory in the near term? Is the run rate of around $850 million plus or minus a reasonable target?

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

The way I would think about it, in Q2 provisions should roughly match net charge-offs. But, remember, we're bouncing around the bottom with respect to net charge-offs in Commercial. So a material credit can move the needle one way or the other.

Absent that caution, we will build as we grow loan balances. But we should expect to see that offset, perhaps, by further runoff of non-core consumer real estate and we have a high energy reserve.

Q - Steven Chubak {BIO 18457976 <GO>}

Great. Thanks, Paul. And just one final question on capital return, just touching on John's last question. How should we be thinking about the capital return trajectory, given the 150 basis points of excess?

I'm also wondering whether some of the recent rhetoric from the regulators suggesting a disinclination of sorts to have a qualitative CCAR failures, whether that informs your approach at all in terms of future payouts.

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

I think we have been building our capital ask year-over-year, and you should expect us to continue to do that since we have both a strong cushion under CCAR. We'll see with this year's results, we don't know yet obviously. But from last year, just extrapolating, and also our start point is higher, and our run rate of earnings is now very consistent. So capital return's part of our story, we'll continue to pursue it.

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

We've made progress every year, you've seen that, and I would remind everybody that we tapped the de minimis last year as well. So with the stability of our earnings, with the progress we're making on CCAR, as Brian said, we hope to continue to make progress.

Q - Steven Chubak {BIO 18457976 <GO>}

Thanks for taking my questions. Congrats on a strong quarter.

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

Thank you.

Operator

And we'll take our next question from Ken Usdin with Jefferies. Please go ahead.

Q - Ken Usdin {BIO 3363625 <GO>}

Thanks, morning. Just a first clarification, just coming back to the NII commentary, does the 150 also incorporate the extra day you get in the second quarter, because that's usually pretty meaningful for you guys?

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

Yeah, I would think about the extra day as kind of being offset by the seasonality we have in Q1 for leasing.

Q - Ken Usdin {BIO 3363625 <GO>}

Okay. So you're say you've got a benefit in the first, and that kind of washes through the second. So really, your net is the 150?

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

Yeah, approximately 150, and as you know, there's a lot of things that go into that modeling.

Q - Ken Usdin {BIO 3363625 <GO>}

Understood. Okay, great. So, on the consumer fee side, I wanted to just ask, we saw kind of a little bit of a positive turn in both card income and also in the brokerage line, which is first time in a while we've seen both of those move the right way. Any better line of sight at this point on just the trends getting better underneath the surface, whether it's the rewards competition or the fee capture pressures in brokerage kind of starting to get into the run rate, and we can kind of expect to see growth from here?

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

Look, we've seen modest growth in card balances. We think that should continue. We're adding new accounts. We added 1.2 million cards this quarter. Combined debit/credit spend was good year-over-year and really good recently. But as you point out, the card income line remains – I think, in terms of growth, remains muted by competition around customer rewards.

I guess, what I would point out and just remind everybody is that just focusing on the fee income line sort of ignores some of the key benefits of our strategy, which is attract relatively higher quality card customers and reward them for deepening their relationships with us.

This strategy, we think, is driving incremental deposit growth and making them stickier, and that helps NII. And by the way, these customers have lower loss rates as well as reduced need to interact with call centers. So that helps us lower costs. In terms of the service line or service charges, they've shown some modest growth driven by growth in new accounts. And we expect that probably to continue here.

Q - Ken Usdin {BIO 3363625 <GO>}

And can you just touch on brokerage?

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

You mean brokerage...

Q - Ken Usdin {BIO 3363625 <GO>}

Wealth and brokerage.

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

Yeah. Well, wealth and brokerage is being driven by the long-term trend that we've been seeing with growth in AUM, as transactional brokerage continues to decline. We saw that again this quarter. This quarter, we had significant growth in AUM, which offset that sort of continuing decline in brokerage. I think AUM fees were up 8% this quarter.

Q - Ken Usdin {BIO 3363625 <GO>}

Got it. Okay. Thanks, Paul.

Operator

And we'll take our next question from Betsy Graseck with Morgan Stanley. Please go ahead.

Q - Elizabeth Lynn Graseck

Hi. Good morning.

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

Good morning, Betsy.

Q - Elizabeth Lynn Graseck

A couple of questions. One on the expense discussion earlier. On page four, you highlighted very clearly the strong operating leverage that you've got year-over-year for the various industries, various segments that you run. So the question I have is, where should we expect the next leg of improvement on expenses could come from? Because one of the questions I've gotten from people today is, this is fantastic operating leverage, but where are the levers to take it further?

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

So, I think when we started a few years ago at $70 billion operating expenses to bring it down to this level, it was more obvious. Betsy, now it's everywhere. It's everywhere, a little bit everywhere and a lot of hard work. So the head count generally is drifting down, year-over-year term, 4,000, 5,000 people. That gets harder, but what we're doing is taking out people and putting them into the frontline in the client-facing roles, and so we're seeing that shift go on.

We're continuing to work our real estate portfolio down again through co-locations in cities. So you'll see us take three buildings in an area and put them in one, and you've seen some announcement in that regard. In our data centers, we're accelerating the process to consolidate data centers, and that helps continue to knock down the number of data centers. It takes $0.5 billion investment or $0.25 billion investment to build one to bring it in. And so you'll see that go on. And then it's everywhere return, every place we look just keep working at the pieces.

But at the end of the day, continue to watch the FTE head count numbers drift down and also how we move those around from less managers to more client-facing people and less layers in the company, which we've been after. And so it is just hard work across the board using our Simplify and Improve and what we call organizational health going on in our company, and we're seeing the aspects of that.

That, by the way, I think, last, in 2016, to give you an example, I think, we invested about – we got about $400 million, $500 million in savings from some ideas. But it took us an investment of a couple of hundred million dollars to get that. And so...

Q - Elizabeth Lynn Graseck

Got it.

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

... even that investment rate is important to getting the sales out. And so we're not asking you to exclude, but there's severance cost in here, there's real estate reposition costs, all of that, which actually comes down as you get further and further towards the optimization level.

Q - Elizabeth Lynn Graseck

Okay. So that speaks to why you can continue the revenue growth but yet still bring the expenses down. Got it. Two other quick ones. One, on fixed income, you mentioned that credit was a source of strength this quarter. Others have highlighted credit as a weakness. So maybe you could speak to what you're seeing in your client base that drove such a strong credit quarter in effect?

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

Well, first, I would say, look, we've been making a lot of investments in our Global Markets business across equity, across macro. Credit has always been a traditional strength of Bank of America Merrill Lynch, a lot of very strong bankers combined with strong sales and trading effort.

Corporates raised money this quarter in the capital markets. We have a strong relationship. So we saw a lot of increased activity on the primary side, which helps your sales and trading on the secondary side. That's one.

Two, with spreads tightening a little bit and with clients activity picking up, as they were repositioning, given the change in markets, the change in spreads, again, we have a strong corporate credit trading desk. We have strong special situations in credit. We have a strong mortgage, and they just saw a lot of client activity, given what happened in the quarter.

So we've often said, when client activity picks up, you're going to see this business perform. And for us, client activity was more this quarter, and it showed up in our results.

And again lastly, it's a breadth of products. It's significant presence in scale in every major market around the world. So it's not just the U.S. We saw activity in emerging markets around the globe. And we were there for when our clients needed us.

Q - Elizabeth Lynn Graseck

Okay. Thanks. And then lastly, you mentioned on the call during the prepared remarks that you 'remain mindful' of the LCR rules as we grow deposits. Could you elaborate on your thoughts behind that?

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

Sure, particularly on the wholesale side, there are three types of deposits fundamentally, 25%, 40% and 100% runoff. And as we think about serving our customers and clients, we're mindful, very mindful of their needs, but we're also focused on maintaining those. Having deposits of the highest quality in terms of being able to use to lend out to customers, so that means you've got to focus on the 25% and 40% or the more – the deposits that are much more operational in nature, deposits that we know our corporate and FI clients are using to run their businesses.

We're focused on growing those deposits, and we're focused on helping them use those deposits to pay bills and to move their money around, to do FX, all the things you might think an individual does, but just on the corporate side. Those are the types of deposits we're focused on. We're respectful of clients who want to give us other types of deposits, but we're having conversations about them about the value of those and therefore what they should expect in terms of pricing.

Q - Elizabeth Lynn Graseck

Okay. Paul, thanks very much and Brian, thanks a lot.

Operator

And we'll take our next question from Gerard Cassidy with RBC. Please go ahead.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Good morning, Brian, and good morning, Paul.

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

Good morning, Gerard.

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

Hi.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Brian, when you look out longer term, and if you turn back the clock, when the industry before the financial crisis typically earned 120 on assets or 130 basis points on assets in a more normal interest rate environment, what do you see further along?

I know ROE is what you focus on, and we all do. But from an ROA standpoint, when everything's going right for Bank of America, the expenses are where you want them to be, the margins are where you want them to be, what kind of ROA do you think this company is capable of producing?

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

Well, I think, Gerard, just the focus we've talked to you about getting at above 100 basis points and then with the adjustments of sort of smoothing out the first quarter a little bit from the one-time sort of annual expenses that occur in the first quarter, you're getting close to that.

That is not an aspirational goal, which we'll stop at. I mean, I think, it'll improve, if the rate structure continues to move up and the economy continues to grow, we'll get above that. But the first order of business is to get above – to get to that so that we get the returns on tangible common equity and returns on equity where we want them to be.

As you're thinking about that just more broadly, remember that we have a balance sheet of $2.3 trillion or so and think about $500 billion basically being completely liquid assets, that is a far different cry than we were – when our balance sheet sort of at the high point was $2.7 trillion, and we probably had $200 billion or $100 billion to $200 billion of high quality assets or whatever the moniker we've used back then was.

That's going to knock around your yields on your balance sheet. And so we do focus on ROA in our company because it basically is the thing that ultimately drive ROE. That this equity builds, their ROE can be under pressure just from increases in equity. But if you think about it, the real driver of the yield on the balance sheet has more to do with the amount of assets you're carrying which are underleveraged for purposes of liquidity and safety and soundness.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Right. Okay, thanks. And speaking of the lever on the equity, can you remind us what the risk-weighted assets are now for the operational risk for you guys?

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

Sure. We have $500 billion in RWA for operational risk, which is if I can go on a little bit, which is one-third approximately of the RWA of the company under the advanced approach and more RWA than we have for our credit.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Very good. And then coming back to the combined payout ratio that you guys are striving for, within that, what should we envision for once you get your capital levels to the point where you're very comfortable with? Is a dividend payout ratio of 30% to 40% a reasonable expectation down the road when things more normalize?

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

A couple things. One is our capital is more than sufficient. We're very comfortable with it with a tangible common equity ratio, Gerard, thinking about before the crisis of 7.9% and a CET1 of 11% with a minimum of 9.5%. We have more capital than the company needs by the different measures, whether it's a traditional market-based measure or a regulatory measure. So we're completely comfortable with that.

That leads us to return more capital. You should expect our dividend payout ratio will – for the bigger companies, I think, there'll be more focus of keeping that to 30% level that's been talked about in the various rules and regulations. And if you go back three or four, five years ago, I spoke to that at one of our industry conferences, I think if you look across time, that level of – just if you think about that level of payout against the earnings stream, there's very low probability that you'll have real danger in the dividend, continuing that dividend even in tough times. So our goal is never to keep the dividend stable and then use the excess capital to buy the stock back at around book value we think it's great trade.

Q - Gerard Cassidy {BIO 1505265 <GO>}

(1:00:42) then, Paul, just circling back to your comments about the FICC – the strength in FICC, the client activity was strong, can you give us some color on the clients? Was it primarily investment clients or hedge or pension funds, hedge funds? What type of clients did you see that strengthened activity?

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

I think it was – the only way to really classify that it really across the board. I think we have strengths in all of those client sets. There's just a lot of good sales and trading activity driven by client interest in repositioning their investments but also again driven by prime new issuants (1:01:16) of our clients. We just have a very broad and diverse product set in FICC, both from a product perspective and a geographic perspective, and that kind of footprint and that kind of diversity when clients want to make changes, we're a natural call.

Q - Gerard Cassidy {BIO 1505265 <GO>}

Great. Thank you. And, Brian, thank you for batting clean-up and not lead-off. It made it a lot easier for all of us today. Thanks.

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

Okay.

Operator

And we'll take our next question from Saul Martinez with UBS. Please go ahead.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi, good morning, and congratulations on the results and on the progress. Couple of questions, first, can you comment on the sustainability broadly of your returns in your Markets and Banking businesses? 15% return on allocated equity in Markets, 18% Banking, despite the fact that you increased your capital allocation there.

Obviously, if you can sustain those kinds of returns, it goes a long way towards helping you hit your 12% RTCE targets on a sustainable basis. So just can you comment broadly on how confident you are to – in your ability to, say, hit sort of mid-teen returns in those businesses?

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

We have been getting in Global Markets a double-digit return now for a number of quarters. It's been in the 10%-ish, 11% range for a number of quarters. So I feel like in Global Markets we've made a tremendous amount of progress in improving returns.

In Global Banking, and remember this quarter they did 15%. But this quarter I think we had a very strong quarter in sales and trading. Our performance in Global Markets is going to be a direct result of client activity as we say every quarter. So when client activity is lower, our results will be lower, but through a number of different quarters now with varying amount of client activity, I think we've been able to get that 10% or more return on equity. So that's how I'll answer it from that perspective.

In Global Banking, again, those returns are somewhat dependent on client activity in investment banking, but there I think the Global Banking segment is less volatile with respect to returns tied to the Investment Banking fee pool in any given quarter.

We've got a diverse product set across Treasury Service, Traditional Corporate Banking products and Investment Banking products. And then from a client perspective, we're the full spectrum: small, medium-sized and large global companies. So there, I would expect us to be able to maintain that return level.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay, that's helpful. Yeah.

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

The thing I'd add to that is, if you think about what we did, we took Global Banking because we think that's an integrated business, whether it's Corporate Investment Banking with both the Corporate side and the Investment Banking side or middle market banking, what we call Global Commercial Banking, again with Investment Banking, Capital Markets behind it, obviously, less than GCIB yield.

We split that out to show you that that business many years ago we broke Global Banking away from Global Markets to show the distinctness of the business at Global Banking was more of annuity stream driven by Treasury Services revenue, lending revenue and net investment banking fees, which ebb and flow based on client activity and returns are fairly consistent, et cetera.

The flip side was we also wanted to show, I think, doing this five, six years ago when we first did it, have been doing it ever since, and we're one of the few companies that does it on the Global Markets side. You can see that there's actually more stability in that business than a lot of people thought.

So if you look at the low end, we might make $600 million, $700 million after-tax; on the high end, we made $1.3 billion this quarter, but you'll see this range. And if you look across years of quarters and look at comparative quarters year-over-year because there's some seasonality, you'll see it's relatively stable. And so, we sort of hit that double-digit level in the worst of quarters during a year and then in the best of quarters, it'll kick above it.

That was again how Tom and the team – Tom Montag and team -- run the business. The stability we put in and then most importantly, was bringing the expense structure down dramatically five or six years ago, Tom and the team did by almost $1 billion in quarter in operating expenses just in this Markets business alone and then maintaining it there and continuing to push it down where revenues have stabilized and come back up.

Q - Saul Martinez {BIO 5811266 <GO>}

Yeah. No. Thank you. That's helpful. I mean, obviously one of the things that's been helpful for returns in banking is very benign credit environment, and I think commercial charge-offs were 10 basis points this quarter. It hasn't really moved much in recent quarters, but how should we think about more of a sustainable level? And is there anything there that makes you think that you could start to see some sort of inflection or some sort of an uptick in terms of credit costs?

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

Are you referring to more sustainable on the net charge-off side?

Q - Saul Martinez {BIO 5811266 <GO>}

Yeah, exactly. On Commercial.

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

I guess, how I would answer the question is we have been – we changed our underwriting standards years ago. We've been focused on responsible growth now for a number of years. We've been sticking with that improved client selection, heightened credit standards. So the answer is we can't compare to a previous period in the company's history.

We're just going to have to see how this develops, but we're very confident. We don't see anything today as we look at what's going on in the marketplace that would suggest that we're at an inflection point. Doesn't mean that I won't be talking to you next quarter about having lived through an inflection point, but we're not seeing anything right now that would tell us that we should expect net charge-offs to rise in the near term.

In the long term, there is some seasoning going on in the credit card portfolio that we expect and we've talked about before, but outside of that, we feel good about where our credit card (1:07:37) quality is.

Q - Saul Martinez {BIO 5811266 <GO>}

Great. Thank you very much. That's helpful.

Operator

And we'll take our next question from Brian Kleinhanzl with KBW. Please go ahead.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Great. Thanks. Yeah, I just had a quick question. I remember you were saying that both the business or the Commercial customers and Consumer customers were optimistic still. But did you see a change in that optimism over the course of the quarter? I mean, did it end lower at the end of the quarter given what was going on with D.C. and everything else or was it fairly consistent?

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

I could say consistent. And if you looked at spending, I think, it actually maintained its pace through the quarter. As an indicator of their behavior, March was a stronger month than the first two months of the quarter.

Now, you can get into day counts and movements around which weekends fall, but just we didn't see any fall off in terms of their behavior in spending, which I think is a good indicator of how they feel.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Great. Thanks. That's all I had.

Operator

And we'll take our next question from Matt O'Connor with Deutsche Bank. Please go ahead.

Q - Matt O'Connor

Hi. I just wanted to follow-up on the net interest income one more time. I mean, it feels like the 2Q expectation is a little bit less certainly versus what I would have thought. And I guess what I'm trying to figure out is just some conservatism on the deposit or pricing assumption.

You talk about 50%, but it's been really insignificant so far for the Fed hikes. I'm trying to gauge, is it conservatism on that? Is it the fact that 10-year has obviously come in a fair amount or some combination of both maybe?

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

So I'm not going to take you through the math again because the math is fairly self-explanatory. But there are a lot of assumptions or I should call them assumptions but there's lot of things that go into the modeling of NII.

You hit upon one of them. Obviously, we could have deposit betas that are different than what we're expecting as we're doing our modeling. The 50 basis points obviously is for a full 100% shock. We're talking about a 25% shock. So it's reasonable to expect that we would be lower than 50% for that first 25. I think the question is, how low should we be, and we're just going to have to wait and see. We're very focused on the competitive environment. We're focused on the needs and wants of our clients, and we're focused – we're balancing all of that against what our shareholders would want us to do. So we're going to just have to see how it develops, but there's a lot of things that go into the modeling of expected NII.

Q - Matt O'Connor

Okay, understood. And then just the impact of long-term rates, I mean, obviously, the comment you made on rate leverage is for higher rates and you're 75% levered on the short-end. But as we think about the decline here in long rates if it holds, how frame kind of the drag on that and I think it breeds in over time, obviously, not all at once.

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

Yeah. The sensitivity on the long-end is a function of being able to reinvest as assets mature at higher or lower rates than the average we have now and what it does to the amortization of our premium on our securities portfolio. The latter is a bigger driver in the short-term. The former is a bigger driver in the long-term. If you think about the company right now, where long-term rates are, we've said this on our other calls we're kind of – we used to be at equilibrium where an asset rolling off the balance sheet was being replaced by assets rolling on the balance sheet at roughly the same yield.

I would say we're in a little bit more positive place right now, even where rates are having long-term rates have gone up here over the last two quarters, we're sort of in a position where an asset rolling off the balance sheet on average is being replaced by an asset coming on at slightly higher yield. So I don't know if that helps you?

Q - Matt O'Connor

Yeah, no, that's very clear and very helpful. So, thank you.

Operator

And we'll take our next question from Marty Mosby with Vining Sparks. Please go ahead.

Q - Marty Mosby {BIO 14008907 <GO>}

Thanks. Two technical issues on the kind of net interest margin NII. When you look at the big benefit in net interest margin, it seems like you had several things like the hedge ineffectiveness and leasing that pushed the margin up, and even though you can have NII growth, your margin may even kind of just flatten out. Is there kind of a bias towards the margin just being little bit higher given some of those moving pieces this particular quarter?

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

Look, the bulk of the increase from Q4 to Q1, the $700 million, the bulk of it was due to rates. We just highlight that there was meaningful improvement that was driven by the leasing seasonality. Think about that as roughly the kind of improvement we get with an extra day in the quarter.

And then there was, I think, significant improvement driven by the lack of hedge ineffectiveness in the first quarter relative to what we experienced in the first quarter. But the bulk of it was driven by rates. And if you think about the rate impact, more than half of the rate impact was driven by the long end as opposed to the short end.

Q - Marty Mosby {BIO 14008907 <GO>}

And I would just focus in on the margin in a sense just like it was just rounded up because the things that are going to help next quarter are going to help NII, which may not help the margin. But then the second question was when you look at your transfer pricing mechanism, was curious because it doesn't seem like a lot of banks would have the benefit from (1:13:35) showing up in corporate other. Is your mechanism where it's still spread some of that – does that matter on operating leverage for the business segments, so are the segments going to benefit as rates go up more than corporate? It does seem like it's spread out more than other banks.

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

I think over the longer – any one quarter, it could be a little bit lumpy how the company overall benefits versus the segments. But I think over time, over multiple quarters, the segments will benefit. It's just basically a function of how residual flows back to our segments.

Q - Marty Mosby {BIO 14008907 <GO>}

It is. It just seems like you've got a good methodology to push it to the segments, which is helping operating leverage in each of those segments as you're getting that benefit. Thanks.

Operator

And we'll take our next question from Andrew Lim with Société Générale. Please go ahead.

Q - Andrew Lim {BIO 15232581 <GO>}

Hi. Morning. Thanks for taking my question. Another NII question actually. I'm just trying to understand the mechanics of how your guidance in 4Q for a $6-billion uplift in NII for 100-basis-point shock has come down to about $3.3 billion there. If I understand correctly, the long-end has increased.

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

Yeah.

Q - Andrew Lim {BIO 15232581 <GO>}

So that reduces your guidance going forward. Is that the way to think about it?

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

Yeah. I think, if you look at our disclosures, you'll see that the 100-basis-point rate shock at the end of the year was basically the same as it is right now. You're referring to what we reported at the end of Q3 being 4-point something. And that decline in benefit we experienced as rates rose, and that went into our run rate of NII that as Brian mentioned earlier.

Q - Andrew Lim {BIO 15232581 <GO>}

What I've got a difficulty understanding is why the past movements in your long rates should affect your future guidance going forward. So if I think about hypothetically let's say the yield curve did actually go up by 100 basis point shock in the fourth quarter, then your guidance going forward would actually be zero, based on the way you view that. Is that the way to think about it, or am I missing it?

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

You have to go back. If you look – you can follow up with Lee afterwards, but if we think about what we told you in the fourth quarter, from the third to the fourth quarter, I think you may be off a quarter. From the third to the fourth quarter, what we said is you basically capitalized into the earnings run rate. That $2 billion difference is now in the earnings run rate, and that's what you're actually seeing, and that's the benefit of the lift in rates, especially on the short term side. And so that is relatively stable now, because that piece went through it. So Lee can follow up with you and take you through sort of the calculation, but it's because the good news is it showed up in earnings this quarter as we said it would.

Q - Andrew Lim {BIO 15232581 <GO>}

Oh, yeah. No, no, absolutely. I can see that. Just trying to see how that moves depending on the shift in the curve.

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

Well, because the future investment rate on the long-term rates as it comes down as the earlier caller talked about affects our yields on our securities portfolio going forward, so, yeah, as we reinvest $20 billion plus a quarter. So I'll get Lee to call you afterwards and take you through that.

Q - Andrew Lim {BIO 15232581 <GO>}

Okay. Thanks.

Operator

And we have no further questions at this time. I'd like to turn it over to Mr. Moynihan for any closing remarks.

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

Well, thank you all of you for your time. Just to remind you this is a quarter where we showed a responsible growth coming through. Revenue growth of 7%, flat expenses, 700 basis points of operating leverage, across our franchise good client growth in each of the business, and our asset quality remains strong. So we look forward to talking to you next quarter. Thank you for your time and attention.

Operator

This does conclude today's call. You may disconnect at any time, and have a wonderful day.
