Q2 2020 Earnings Call

Company Participants

- Brian T. Moynihan, Chairman of the Board and Chief Executive Officer
- Lee McEntire, Investors Relations Contact
- Paul M. Donofrio, Chief Financial Officer

Other Participants

- Betsy Graseck, Analyst
- Brian Kleinhanzl, Analyst
- Charles Peabody, Analyst
- Glenn Schorr, Analyst
- Jim Mitchell, Analyst
- Ken Usdin, Analyst
- Matt O'Connor, Analyst
- Mike Mayo, Analyst
- Saul Martinez, Analyst
- Vivek Juneja, Analyst

Presentation

Operator

Good day, everyone, and welcome to today's 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. (Operator Instructions) Please note, today's call is being recorded.

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

Lee McEntire {BIO 6651246 <GO>}

Good morning. Thanks for joining the call to review our second quarter results. I trust everybody has had a chance to review our earnings release documents. They are available in the Investor Relations section of the bankofamerica.com website. I'm going to first turn the call over to our CEO, Brian Moynihan for some opening comments, and then, ask Paul Donofrio, our CFO, to cover some other elements of the quarter.

Before I turn the call over to Brian, just let me remind you that we may make forward-looking statements during the call, and for further information on those forward-looking comments, please refer to either our earnings release documents, our website, or our SEC filings.

So with that, let me turn it over to you, Brian. Thanks.

Brian T. Moynihan {BIO 1517608 <GO>}

Thank you, Lee, and thank all of you for joining us for our results. As I step back and thought about talking to this quarter, I thought back to our discussion of last quarter's results in mid-April. As we were talking, we sat in the depths of the COVID-19 crisis. We thought we are seeing a rise in virus cases. We completed a massive move in our company and companies around the world to work from home. We were closing branches for safety and other facilities.

We had a million customers who had already purchased by mid-April, asking for assistance in terms of paying their loans. We had seen a massive amount of commercial line draws in mid-March to mid-April and loan request out of panic and the need to create instant liquidity, and we saw flooded deposits, looking for a safe haven at the same time.

We had, at that time, the core economic projections. We're still catching up to the worsening predictions of the future, and the reality of the health officials projections to the virus path and reality of shutdown or stay-at-home orders, and now, we're a quarter later. In some areas, the cases are still rising. In some areas, are rising less. Economic predictions have been revised in the forward path, has deteriorated from last quarter.

Baseline projections now extend the length of the recession environment into 2022, deep into 2022. We provide substantial additional reserves for expected future credit losses this quarter to reflect that it has impacted our earnings. But in other hands, there have been some encouraging signs. Consumer spending activity has vastly improved since April. Spending by Bank of America consumers during 2019 was a total of $3 trillion, so it's a sizable sample of US activity.

For the month of April, that spending was down 26% compared to April of 2019. However, for the month of June, that spending was relatively flat to 2019. And so far, through the first couple of weeks of July, we're seeing that total spending actually be above what it was last year. Customers and businesses have adapted to a new environment. Some have reopened in US, some have also been re-closed or limited again. We expect to start/stop to be the base case as we look ahead.

At present, core operating assumptions for making our credit projections in our reserving by the unemployment stays elevated in the end of this year around 10%. It remains at 9% in the first half of 2021 and 7.5% at the end of '21. In that provision setting scenario mix, it takes some time until late 2022 or early 2023 for the aggregate GDP level to get to the same size it was heading with the 2020, so it will be a bit of work to get back to that level.

The central banks around the world led by actions of the Fed provide unprecedented liquidity in the financial system. US government has also provided direct payments through unemployment supplement EIP, the PPP program, and many other things to help American citizens weather the storm. Due to all that, the number of things are in fact different from our last quarter conversation.

Panic borrowing has dissipated as a market to provide a financing source of many companies to extend the maturities. Most companies have stabilized our operations. Draw rates and middle market lines of credit are back to levels that they were mid last year.

In the smaller business segment, they are actually down as companies do not need the liquidity. While many companies may not like where they are in terms of revenue or growth, they have stabilized. Consumers are benefiting from direct stimulus and deferrals on loan payments from banks. As such, the delinquencies are far lower than what would be predicted in an 11% unemployment scenario. Consumers have more money in our accounts. For those that received the PPP small business that received it at Bank of America, we estimate that the money has been spent out of the PPP proceeds at only 35% level so far, so 65% is left to be distributed from those companies to their employees and other vendors.

Coronavirus assistance requests have fallen. The consumer, what we call CAP program, the week of request for the last few weeks are down 98% from where they were in mid-April. The question we all get asked is when will the storm hit. That is and has always been a healthcare question on an economic note. So, our job continues to be prepared for whatever the economic scenarios the head brings. And how do you get prepared was too late to start in the second quarter 2020. We did that through our adamant team decade long in an effort to drive responsible growth in our company. Portfolio is in great shape heading into this year. And in the second quarter, we reviewed our commercial loan portfolios at a customer level across our businesses.

Our risk ratings are up-to-date. We're moving credits quickly to criticize our NPL designations. We've also gone through every credit to assess the need that they'll have to borrow in the near term for liquidity and business prospects. On our consumer books, we also benefit from the decade-long improvement in our underwriting standards. We've remained consistent. Since the virus have rising unemployment related matters, we paired our consumer risk appetite.

The key difference in our company now versus the last crisis is the unsecured card portfolio that is basically half of what it was going into the Great Recession and with better asset quality. Another example of difference is our commercial real estate, especially far less exposure, especially in the construction area. We saw a recent stress test prove this out again, as we have the lowest losses among the large firms for the seventh out of the past eight stress tests the Fed has run.

We've also improved our fortress balance sheet even from year-end to today, all this amidst this crisis. We have built liquidity. Our liquidity at the end of the quarter was up $800 billion on an average. It is significantly up from year end. We've doubled our credit reserves to $21 billion from where they stood at year end.

We've built our capital levels, resulting in the common equity Tier-1 ratio at the end of the quarter of 11.4% versus 11.2% at year end. And we're 190 basis points above the regulatory minimum, and as we disclosed to you after the stress test, we have room even within a stress capital buffer as we're [ph]flowing at 2.5% level despite the 2% actual calculation.

We earned $7.5 billion year-to-date even as we built those reserves, and we returned $10 billion of capital [ph]in the first half. By the way, charge-offs this quarter was stable and the ratio remained low at 45 basis points this quarter, and our NPLs have increased modestly in this environment despite scouring portfolio for rating changes.

Quarterly expenses of $13.4 billion remained in a tight four-year long range of $13 to $13.5 billion with little exception even though we continued our investments over the period and incurred higher COVID operating expenses. During the crisis, we also have a blast away on our strategic programs. During the first half, we have driven our promises as a digital leader across all our businesses. Our capabilities enabled smooth transitions for our companies and our institutional investors and our people, who we work with as customers, whether they are working from home or shelter-in-place to transact the financial business, whatever way they want to. Where this goes, we will see.

Our raw data has provided some signs of cautious optimism. We emphasize cautious here. [ph]We aren't in the -- we ask misstate here. We are being diligent and we're making sure we keep our company strong. At any regard, we are ready for whatever happens because of last decade of hard work on responsible growth. Most importantly, we're ready because we have 212,000 talented teammates to work on everyday, to come and do a great job for the customers communities, and our shareholders.

So let's drop in the quarter two results. We're going to slide 2 and slide 3 together, and I'd ask you to refer to that combination, the commentary on 3 talks about the charts on slide 2. This quarter, we showed the balance in our company where more credit sensitive businesses saw lower earnings due to provisions and lower rates impacted our fast growing deposit 10s of businesses. Our position as a top capital markets platform for issues and institutional investors allows us to produce solid overall results. Market served as an anchor to win for the company.

In the second quarter, we produced $3.5 billion of net income. This concluded building our loan loss reserve by $4 billion due to a total provision expense of $5.1 billion. Earnings were $0.37 per share. Earnings were down $3.8 billion from the second quarter of last year, driven primarily by our reserve bill. As I did last quarter, I think it's useful to draw your attention to the pre-tax pre-provision income number. We believe that number helps assess the earnings power of the company to support credit costs in the downturn.

We produced $8.9 billion of pre-tax pre-provision income, which was down 9% from quarter 2019 given the changes in interest rates, in the growth of deposits, and the impact it has on our company. The forgiveness in fees we've made to help accommodate our consumer -- customers and time of stress and the overall lower economic activity of record drops in this quarter. It shows pretty remarkable resilience. In fact, it's just below the average of pre-tax pre-provision income for the level of the past four quarters.

The 3% year-over-year decline in revenue was driven by lower NII. NII fell to $11 billion this quarter, bearing the brunt of the significant first quarter rate cuts for the entire quarter. Mitigating the revenue decline from NII was strong global markets results.

Sales and trading revenues excluding DVA of $4.4 billion were up 35% year-over-year. Investment banking fees of $2.2 billion are of record and grew 57% year-on-year. In aggregate, we saw $1.9 billion improvement in sales and trading investment banking year-over-year. Most importantly, and we think about profit in this company, our global markets team produced $1.9 billion in after-tax profit as a separate segment. Our non-interest expense was $13.4 billion. As I said earlier, it has included roughly $400 million in net impact of expenses and savings related to COVID-19. Our return on tangible common equity was 8%.

Let's go to slide 4. Here, we note the continuation and expansion in the programs to support our teammates and clients initiated last quarter. In quarter one, we established broad measures to promote the health and safety of our teammates and help limit their exposure to COVID. In quarter two, we continued to expand those efforts and have remained mostly in the work-from-home posture with less than 50% of our employees in offices, financial centers or call centers around the world.

We continue to provide ongoing access to comprehensive benefits and resources such as enhanced backup childcare and adult care services among and many other supplements and incentives for frontline associates, and all those costs are in the numbers you're seeing this quarter. And we order our commitments to hire the 2800 students for summer jobs and permanent jobs coming out of college. Taking care of employees is the right thing to do. It enables each of them to play the important role they must as providers of critical services for the US economy and the worldwide economy.

In addition to keeping our financial centers open to serve clients continuously through the crisis, we continue to offer assistance in our commercial consumer and small business clients affected by COVID. These actions include payment deferrals, refund of certain consumer fees, positing certain foreclosure sales, repossessions of cars, evictions, and other matters.

One noteworthy past was the PPP, the Paycheck Protection Program. We originated the largest number of loans in that program at 334,000 plus small business clients receiving loan providing funding of $25 billion. We also supported the communities we live in. After announcement in quarter one to donate $100 million to fight the immediate effects of the pandemic, we announced a new initiative in quarter too. We've recognized there are communities in certain people to limit this and disproportionately impacted by this healthcare crisis and in the elevated racial tensions that existed for years in this country.

We announced [ph]a $1.4 billion to advance issues of race equality, economic opportunity, and healthcare initiatives. Our market presence and other leaders throughout the country are busy working to play their vital role in helping us plan how we deploy those critical funds into critical actions. I'm proud of how my teammates serve the customers and clients during this COVID crisis, but I'm even prouder how they're playing a part a bit more gently to help.

On page 5, we discuss the deferrals. The assistance program -- the customer assistance program, as we call it CAP, for our clients to provide easy access to request loan deferrals and ease their immediate financial burdens. The crest built quickly peaking in the first week of April, 415,000 requests in a single work. They started dropping in that point and have continued to drop. By mid-May, the requests fell. In the last few weeks, we've been consistently 98% below that peak. In total, we processed 1.8 million consumer deferrals with about 1.7 of those remaining as we enter July. This represents $30 billion of consumer balance with payments on deferral.

The large numbers of process deferrals, as you can see, are our credit card holders. Another area to concentrate request is the practice solution group in small business. Let me provide a little deeper insight into these categories. You can see it on the lower right-hand part of the slide. Our credit card, 85% of deferrals were initiated in late March, early April and has died down since then. 95% that initiated were current on the payments when the deferral was a question. More than 60% of the active card deferrals have made at least one payment since going on deferral. One-third have made every payment every month. As we look forward, if there are no other major changes of consumer spending habits are major macro deterioration, we'd expect card deferrals to decline significantly in quarter three, given the expiration and these payment observations.

Importantly, our credit reserving you see in our P&L today reflects the individual credit characteristics of all these deferred borrowers in a higher risk they propose. Small business is where we saw the highest percentage of accounts requesting assistance. As you may recall, last quarter we talked about this. These requests came from our business practice solutions group. These are mostly dentists and doctors who were shut down during the crisis, but now are open. As they reopened, our internal survey shows that 80% of these borrowers as of a few weeks ago were all back to work with steady revenue. In our context to the accounts, 90% indicated no elevated level continue to stress and [ph]importantly this still need not to continue to deferral and will not. This charter deferrals for commercial accounts amounted roughly 2% of our loans, but only 1% of those are unsecured, and through conversations with these borrowers and we'd not expect many of these to request a second deferral.

Now moving on to page -- to slide 6 for consumer spending. After significant slowdown in consumer spending in April, we began to see signs of improvement, beginning in May, and whilst still early, we have seen momentum in early July.

Chart on slide 6 shows a seven-day moving average of payments and compares at the same week last year. There are three lines representing credit, debit and total spending. Again, credit was about 12%, debit was about the same amount, and total spending was obviously the free turn I talked about before.

Overall, in the first couple of months of the year, in a healthy US economy, payments were running as high single-digit percentage pace ahead of the same period in 2019. That changed the pandemic spread and the economy shutdown. We saw a severe decline across all payment types, but particularly, in discretionary spending on categories like travel, leisure, and entertainment, which drives credit card spending to lower levels than other forms of payment, including debit card. This is followed by large increase in payments for necessities around groceries and staples like health supplies, but you can see this payments were made directly with debit cards or cash.

As states began to reopen over the past couple of months, we saw an improvement in spending levels as customers became more active, buying fuel and spending on home projects and eating out. Much of the improvements were in pace with debit usage as customers saw stimulus payments and other assistance in our checking accounts.

On a monthly basis, comparing spending to the prior year's month, April '20 was down 26% from April '19, May was down 13% from May '19, and as I said early, June returned to basically flat. We had seen some spending rubbing off on a weekly basis as COVID cases rose recently in hot spots around the country, causing municipalities of states to pause further on further phases of reopening or imposed more restrictions.

But even with that, July is actually running ahead of last year and is much higher during the shutdown periods of early April and May. The peers consumers are demonstrating, they're quickly adapting to the environment by changing shopping habits and moving back and forth between physical and online as needed, and are doing the same with delivery and takeout restaurants as restrictions change.

We continue to minus behavior every day and expect that there'll be starts and stops, as you see the ebbs and flows of cases and people's -- and government's reactions to them and and also until we're going to operate in this new norm.

Let us go to lending activity on page 7 -- slide 7. Here, we see that the borrowing credit shows modest growth beyond the commercial activity involving loans and pay debts. We've seen some modest recovery in some consumer led loan applications, which all dropped in April. As you can see during the quarter, total loans declined $52 billion from the end of quarter one, but there are several dynamics worth mentioning, including the sale of $9 billion of mortgage loans. Within commercial, excluding PPA activity, loans grew $5 billion year-to-date as clients pay down $62 billion of the $67 billion loan growth in quarter one.

While this isn't good for the balance sheet and loan growth, it is a good sign as many borrowers in quarter one accessed emergency panic borrowing to get liquidity, but has since paid those funds back or they have accessed the capital markets and turned out the financing, many of which we were able to assist in helping them do.

As I said earlier, revolver usage has returned to levels in our middle market business about where it was last year, it is lower than those levels in our business --banking business. Consumer lending shows solid residential mortgage growth, but a decline in credit card doing the spending levels I described earlier. The point is there are a lot of

COVID-related activity, but I knew that will stop. There were some underlying demands for loans in the first half of the year.

Mortgage apps continue to be solid despite conservative price and credit of Bank of America. We've also seen auto loan apps fight the way back to the levels they were pre-crisis as dealers have opened and people bought cars. And last, I would note that we continue to supply capital to these customers. Our total commitments have been consistent to our commercial customers. They've remained above a trillion dollars throughout all these periods. And year-to-date, we've approved nearly $160 billion in new expanded commercial commitments for our customers to help them weather the storm.

On deposits, we talk about those in slide 8. We've seen impressive client activity and that activity has continued during the quarter across every single line of business. Since the end of 2019, total deposits have risen $284 billion to more than $1.7 trillion. It is also worth noting that the disciplined pricing with rates paid move from 44 basis points paid to the customer to 9 basis points as short rates declined.

Consumer deposits grew $123 billion or 17%, 69% of the growth has been checking for the cementing our position as a leading core transactional bank for American consumers. Global banking deposits have risen to $118 billion or 31%. Our wealth management deposits were up $29 billion or 11%. Customers continued to value our companies as partner.

Importantly on slide 9, we'll talk about this. It's the last thing I'll mention before I turn over to Paul to go more in depth in numbers. It is our clients' digital Usage. Our customers value the years of continuous investment innovation as they found an ever-increasing need for a digital capabilities in the COVID environment. Providing this true is once again that we are a digital bank and a physical bank. In consumer, there are many examples and I'll touch on a few. Digital logins were 2.3 billion logins in the quarter and have increased 20% in the past 12 months. The average log as per user is also up 40%, demonstrating engagement and quantity of users and depth of use by those users.

More customers discovered the convenience and safety of opening accounts digitally, as the number of units sold digitally increased 20% since last year, representing 47% of sales. We added over a million new mobile check deposit users with a surprising 22% of those being baby boomers or seniors, who've been traditionally hard and engaged digitally. These engagement efforts of keeping our physical centers and call centers running have our customer satisfaction running at all times high at Bank of America.

On the commercial side, we've seen an equally impressive growth in our users and usage, as commercial users have the need for similar conveniences while in their work-from-home mode. In wealth management, in addition to convenient online banking capability and increased engagement, we utilized WebEx and other methods to have secure video conference applications to engage with our clients, which result in household growth in our wealth management business even during the crisis. Digital logins across Merrill clients were up more than 100% year-over-year and 39% of checks deposit were digitally versus less than 25% last year.

If you look on slide 10, this looks at the more active consumer segment. A lot of you focus on single purpose payment [ph]priorities. I want to draw your attention to the top right chart, Brazil to luminate how much money is moving through our customers through that system. We now have 11 million customers actively using Zelle every month, adding 3 million in just the past 12 months alone. And you can see in the chart, we nearly doubled the volume of transactions every year for the past four years to now more than 117 million transactions in the quarter. And that volume has resolved near doubling the dollars used to $32 billion of transfers during this quarter. That's impressive gains given the fact that total payment volumes have dropped and [ph]sales-free industries clients and benefits our shareholders through lower cost. Above all, that's better for our customers.

And with that, let me turn it over to Paul.

Paul M. Donofrio {BIO 1533743 <GO>}

Thank you, Brian. I'm going to start on slide 11 with the balance sheet. Our balance sheet ended the quarter at $2.7 trillion in total assets, increasing $122 billion since the end of Q1 driven by a surge in deposits. During Q2, deposits grew by $135 billion while loans declined by $52 billion, as commercial borrowers repaid much of their lines. Excess liquidity continued to be invested predominantly in cash and cash equivalents.

Shareholders' equity increased modestly as earnings exceeded distributions to shareholders. With respect to regulatory ratios for the past two years, our CET1 ratio under the standardized approach has been binding, but this quarter, the ratio under the advanced approach is lower and therefore binding.

Our CET1 ratio under the standardized approach improved 80 basis points linked quarter to 11.6%, primarily driven by an $86 billion decline in RWA. This RWA decline was mainly driven by commercial loan paydowns as well as lower credit card balances. In addition, we early adopted the standardized approach for counterparty credit risk aka SA-CCR for derivatives. Our CET1 ratio under the advanced approach improved to 11.4%, as RWA under advance declined modestly. Also this quarter, we received our preliminary stress capital buffer or SCB from the Federal Reserve pursuant to our CCAR results.

Our stress depletion was approximately 150 basis points, and including the dividend add on, our SCB was a little under 2%. However, as you know, SCBs are floored at 2.5%. So, our minimum standardizing events each one requirement is 9.5% and remained unchanged. The capital cushion above our 9.5% CET1 minimum was $28 billion at quarter end. The CET1 ratio under the advanced approach became our binding ratio primarily due to the impact on RWA of the migration of corporate credit risk ratings under the advanced approach. Our TLAC ratios increased and remained comfortably above our minimum requirements.

Turning to slide 12 in net interest income. On a GAAP, non-FTE basis, NII in Q2 was $10.8 billion, $11 billion on an FTE basis. Net interest income declined $1.3 billion for both Q1 '20 as well as Q2 '19. As we noted on our Q1 call, an experience this quarter, NII fell to roughly

$11 billion this quarter as variable-rate assets repriced lower following a more than 100-basis point decline in average one-month LIBOR from Q1.

Other notable NII headwinds in the quarter include roughly $300 million of higher premium amortization on our asset-backed securities given the lower rate environment and a decline in higher yielding credit card balances. These negative impacts were partially offset by deposit growth coupled with lower deposit pricing. The addition of PPP loans in the quarter was also marginally -- it also marginally aided NII as did lower global markets' funding costs.

Given the sharp decline in NII coupled with the increase in the balance sheet driven by deposit growth, net interest yields declined notably quarter-over-quarter by 46 basis points. Looking at the bottom right chart, the largest driver of that decline was lower interest rates quarter-over-quarter. Another large impact was the increase in deposits, which is modestly helping NII, but diluting net interest yield given that most of the excess funding in Q2 was invested in cash or cash equivalents, earning only 10 or 15 basis points.

We continue to assess uncertainty with respect to the duration of these deposits. Two other elements diluted net interest yield. They are the higher level of premium amortization and the lower balances of high yielding credit cards. In terms of forward NII guidance, we believe the largest impact from the interest rate declines occurred in Q2 as expected.

As we enter Q3, we face a headwind from the paydowns of commercial loans, which could reduce NII by a couple of hundred million dollars. And as a reminder, NII will be impacted by the long end of the curve as our securities portfolio continues to reprice lower. Beyond Q3, NII stability, absent material changes from the economic conditions will be dependent on asset growth and/or redeployment of deposits into higher yielding securities rather than cash.

Beyond NII, as Brian mentioned, the balance and diversity of our revenue streams combined with strong expense management has supported pre-tax pre-provision income despite the unprecedented decline in interest rates. I would also just remind you that short-term rates were near zero in 2014 and 2015 or before rates rose. In those years, we produced solid profits plus today, we have $150 billion in higher loan balances and $500 billion in higher deposit balances with which -- which will benefit NII versus those periods.

Turning to slide 13 and expenses. At $13.4 billion this quarter, expenses were modestly lower than Q1 '20 for three years now. Despite investments in areas such as technology, sales professionals, marketing, philanthropy, new or renovated financial centers, expanded benefits and increased minimum wage, we have managed expenses well and have operated in a tight range of $13 billion to $13.5 billion expense each quarter or sort of the impairment charge taken in Q3 '19.

This quarter was no exception, even with the added costs related to COVID-19. In Q2, we estimate that COVID-related spending versus COVID-related savings netted to an increase in expense totaling $400 million. We will be working hard to reduce this cost as we move through this crisis, while at the same time ensuring that our customers and employees are safe. The higher cost of COVID was mostly offset by the absence of elevated payroll tax when comparing total non-interest expense to Q1.

With respect to expenses beyond Q2, please note that on July 1, we began accounting for merchant services provided directly to our customers versus through a joint venture. Accordingly, again in Q3, we will record revenue and expense for these operations separately as opposed to netting them under the equity method of accounting. As a result, we expect the expense for this business to add roughly $200 million per quarter to our expense run rate.

Additional revenue for merchant services in the near-term should be roughly $100 million a quarter, improving as the economy recovers and operations become even more fully integrated driving increased value for clients. We are excited to integrate merchant services into our lines of business. Merchant services is an important product for many of our clients from small businesses to large multinationals who rely on accepting credit and debit cards for significant portions of their revenue. As such, it is core to transactional banking and working capital management.

Because our LOBs enjoy leading market share across both consumers and businesses, we can innovate, connect, and provide services that add value across the spectrum of payment users, including offering innovations in expedited settlement, enhanced authorization, least cost routing, liquidity management, credit, FX data analytics, and many other products. Our new proprietary platform is flexible, resilient, and enables us to grow and facilitate the evolution of the payment ecosystem as the marketplace evolves.

Turning to asset quality on slide 14. Our underwriting standards have been responsible and strong for many years now. And we expect this fact to benefit us as we advance through this health crisis. One independent indicator of the relative quality of our balance sheet is the Federal Reserve's annual CCAR stress test. Our net charge-off ratio under this year's stress test was once again the lowest of our peers and has been the lowest in seven of the last eight years. Total net charge-offs this quarter were $1.1 billion or 45 basis points of average loans. Net charge-offs rose $24 million from Q1 with an uptick in commercial losses mostly offset by lower consumer losses. Provision expense was $5.1 billion.

Our reserve build was $4 billion, reflecting a weaker economic outlook since the end of Q1, which impacted expected future losses. While we thought increases in commercial or reservable criticized exposures impacted by the virus, overall, credit thus far has been better than expected, as NPLs only rose modestly versus our expectations. As the economy reopened, we saw lower deferral requests, better payment trends from the stress borrowers, a slower pace of commercial downgrades towards the end of the quarter, and faster payments of loan draws than we anticipated.

On slide 15, we break out our credit quality metrics for both our consumer and commercial portfolios. On the consumer front, COVID effects on asset quality remained benign. This is driven by deferrals extended to consumer borrowers coupled with government stimulus for individuals and small businesses. Consumer net charge-offs declined $138 million, which is partially attributable to a deferral, which should provide a better chance of recovery with stimulus and other assistance.

In commercial, we saw $162 million increase in net charge-offs, with concentration in commercial real estate and energy. Our commercial loan book, excluding small business, ended the quarter at 88% investment grade or collateralized. One could see COVID's impact more clearly in reservable criticized exposures, which increased $9 billion from Q1. This increase was driven not surprisingly by exposures to cruise lines, restaurants, real estate, and retailing.

Turning to slide 16. This table provides a full picture of our allowance build since year-end 2019. As you can see, our allowance, including reserves for unfunded commitment, was $10 billion at year-end and has doubled to more than $21 billion, while our overall loan balances are relatively flat. Note that we ended Q2 with an allowance to loans and leases of 2%. I would also note the coverage ratio for credit card increased to 11%, total commercial loans increased to 1.6%, and CRE rose to 3.5%. These ratios reflect our loan mix with consumer concentrated in secured loans with consistent high underwriting standards, which for the past 10 years has focused on high FICO borrowers with whom we have strong relationships. It also reflects the investment grade nature of our commercial portfolio with strong payment and debt service characteristics.

Our increase in reserve from Q1 reflect an outlook based upon the most recent economic consensus estimates. In addition, we continue to include downside scenarios. Awaiting of these new scenarios produced a recessionary outlook with a deeper decline and GAAP to return to positive GDP. It is worth noting that if one looks at the Fed's stress credit losses in the latest CCAR and just assumes that we have pushed all of those losses into reserves today, our CET1 ratio would still be above 10.25% versus our minimum of 9.5%.

Obviously, there remain many unknowns including how government fiscal and monetary actions will impact the outcome and how our own deferral programs will impact losses, but perhaps the biggest uncertainty is how long economic activity and conditions will be significantly impacted by the virus.

Okay. Turning to the business segments, starting with consumer banking on slide 17. Despite the enormous financial challenges of various impacts or COVID-related impacts, including dramatically lower rates, fee reductions, higher provision, and increased expense, the business remained profitable in the quarter, and as Brian discussed, this health crisis has proven the value of our high-tech and high-touch strategy.

The significant investments and innovation in our digital capabilities have been a valuable resource for our customers, complementing investments in our financial centers and differentiating us from peers. Provision expense reflected higher expected future losses from the worsened economic conditions. And note that net charge-offs in the period actually declined. So, much of the financial burden of expected future losses were incurred in the first half of this year.

And because of deferrals, significant charge-offs in this segment are not likely until the end of this year or later. Revenue in this business absorbed of the brunt of the company's NII declines, as the segment has the bulk of our deposits, and this segment also absorbed the brunt of the fee waivers negatively impacting revenue. Card fees were down as a result of lower spending activity as well as fee waivers. Service charges were down as well due to fee waivers and fewer overdraft and related fees as a result of increased balances and customers' accounts.

With respect to expenses, as you know, banking is considered in the central service, and across the country, we have managed to keep 60% of our financial centers open. The team worked through enormous challenges in the first half of the year. To assure ongoing service, which has been a daily balance between the service our customers need and the safety of our employees as well as customers, our costs reflect this balancing act.

We've had a role at the service calls and manage digital interactions, not only for existing products and services, but also for small business applications to the Paycheck Protection Program. Many of these additional personnel work from home. We also continue to invest in the franchise. We added sales people in addition to the associates to handle customer calls as I just mentioned, we renovated and added financial centers, and we increased minimum wages. The expense from these investments continued to be mitigated at least in part by process improvements, digitalization, and technology improvements.

Client momentum continued as we saw average deposits rise $104 billion or 15% from Q2 '19. Even more impressive was the fact that 70% of this growth was in checking accounts, as clients received stimulus delayed their tax payments and slowly are ramping up spending.

Average loans increased 8% driven by mortgage demand in this low rate environment. Mortgage growth was mitigated by a decline in credit card and other consumer balances. We continue to add consumer investment accounts and see strong flows into our Merrill Edge platform. In Q2, we added 9% more customer investment accounts this year than last year, with more than 30% of those added digitally. AUM rose 17% driven by flows and market valuation.

Let's skip slide 18 and move to wealth management, as I think we covered most of the trends already. So referring to wealth management -- to Global Wealth and Investment Management, on slide 19 and 20, here again, you saw lower rates as COVID-related credit costs impact an otherwise solid quarter with good AUM flows as well as strong deposit and loan growth.

Merrill Lynch and the Private Bank, both continued to grow clients, as we remain a provider of choice for affluent clients. Despite our sales force working from home in Q2, we added nearly 6,000 net new households in Merrill Lynch and nearly 500 net new relationships in the Private Bank. Total client balances rose to $2.9 trillion from Q1, driven by the rebound in equity markets. Compared to a year ago, they are up 1% driven by strong growth in deposits and AUM flows and loans.

Net income of $624 million was down 42% driven by a 10% decline in revenue as well as higher provision expense. The revenue decline was driven equally by lower NII as well as fees. Non-interest income decreased 7% driven by lower transactional revenues and lower asset management fees driven by market valuations, partially offset by the benefit of AUM flows. Expenses were stable year-over-year as investments made in the past 12 months in sales professional and technology were offset by lower revenue related incentives and net savings associated with COVID. Provision expense increased from reserves built for future COVID-related net charge-offs, while current net charge-offs remained low.

Moving to global banking on slides 21 and 22. As noted earlier, global banking saw strong average loan growth from Q1 loan draws, record deposit levels and record investment banking fees. But those benefits were not enough to offset the impact of lower rates and higher provision expense as a result of COVID. The business earned $726 million following $1.2 billion from Q2 '19, but this included adding $1.5 billion to the allowance for credit losses this quarter.

On a pre-tax pre-provision basis, results improved 4% year-over-year driven by record investment banking results. In Q2, we were able to improve notably both our investment banking revenue and market share for the second straight quarter. Investment banking fees of $2.2 billion were up 57% year-over-year. This record result included records in both investment grade as well as equity capital markets. While average loans were up 40% from Q2 '19, I would note that repayment of Q1 draws build significantly as the quarter progressed, which will be a headwind to NII in Q3.

I would also note that new loan origination spreads increased quarter-over-quarter and year-over-year. At the same time, we continue to see strong growth in deposits, which were up $131 billion or 36%, even as the rate paid decline following the decline in LIBOR rates. Rates paid are now back to levels seen at the end of 2015 just before rates begin to rise. Growth in investment banking fees, loans and deposits reflect not only what we believe to be a flight to quality, but also the addition of hundreds of bankers over the past few years, increasing and improving our client coverage.

Turning to digital on slide 23, as we have already covered most of the important points around loan and deposit activity on 22, as in consumer and GWIM, our digital capabilities are more important and useful than ever in this health crisis, enabling clients to work from home and seamlessly manage their treasury needs. And it's no surprise that in this environment, we would continue to see increased use of these capabilities.

Switching to global markets on slide 24, our team performed well in an unusual environment producing the best quarter of revenue since the first quarter of 2012. We saw the fixed income market mostly strengthen through the quarter and prices recover from Q1 with particular strength in credit products. As I usually do, I will talk about results excluding DVA. This quarter net DVA was a loss of $261 million.

Global markets produced $2.1 billion of earnings in Q2, nearly doubling the prior year's period and increased 42% from solid Q1 results. Year-over-year, revenue was up 34% from higher sales and trading results and improved investment banking fees, partially offset by the absence of a gain on an equity investment, which occurred in Q2 '19. Expenses were well controlled and flat compared to Q2 '19.

Within sales and trading -- excuse me, within revenue, sales and trading improved 35% year-over-year driven by a 50% improvement in FICC and a 7% improvement in equities. Compared to Q1, sales and trading revenue also improved, as growth in FICC linked quarter overcame a decline in equities from a record in Q1.

Trading comparisons to Q2 '19 for FICC reflected better trading performance across all products, both macro and credit. I think results benefited from improved client flows, credit spread tightening, lower funding costs, and asset prices, which rallied through the quarter. Equity revenue was driven by stronger performance in cash and client financing, partially offset by a weaker performance in derivatives.

On slide 25, note they have few comparisons, which show sales and trading up 28% year-over-year, but otherwise pretty stable over the past several years at around $7 billion.

Finally on slide 26, we show all other, which reported a profit of $216 million, revenue benefited from a gain of $704 million from the sale of $9 billion in mortgage loans, which drove the improvement in revenue from Q1. Our effective tax rate this quarter was 7%, reflecting the 11% tax rate expected for the rest of 2020 due to the greater impact of tax credits related to tax-advantaged investments on lower pre-tax income as well as the related adjustment to the year-to-date tax rate.

Okay. With that, let's open it up for questions.

Questions And Answers

Operator

(Operator Instructions) We'll go first to Glenn Schorr with Evercore. Please go ahead, your line is open.

Q - Glenn Schorr {BIO 1881019 <GO>}

Hi, thanks very much. Two quick clarifications on your net interest income comments of down a couple hundred million, I'm assuming that is off the current base, and then, do we stabilize from there? I heard your comments about depending on how we assess the duration and stickiness of the deposits. So maybe you could talk about how do you assess the duration? It sounds good, but I don't know how you -- if clients can help you assess that, but how do you assess the duration and stickiness of the deposits and what would you redeploy into, if you thought that they were somewhat sticky?

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

Yeah, so just to be clear, we're talking about a couple of hundred million off of from Q2 to Q3. I won't repeat all the kind of drivers of that. Beyond Q3, NII is really going to -- the growth of NII is going to be dependent upon sort of asset growth in redeployment of deposits into higher yielding securities. We've added $284 billion in deposits since year-end. All of that has gone into cash, earning 10 basis points.

So, as we assess the future of this pandemic, as we kind of assess how much of that is going to stick around, and we get a little bit more confident on those two elements that can be deployed into securities, or a portion of that, let's say, could be deployed into securities. And that's -- there's a big difference even in these rates between what you can earn on a mortgage-backed security or a treasury bond in 10 basis points.

So there is some opportunity there, but it has to -- I think would be thoughtful about it and it's one of the things I think you know when you see it.

Q - Glenn Schorr {BIO 1881019 <GO>}

Got it. Maybe a similar question on expenses. The $400 million in COVID-related expense. I'm assuming that's a combination of PPP and work-from-home related things. Does that roll off starting now that stick around? I want to get to that core number that we're adding the 200 of merchant servicing expenses on top of it. Thanks.

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

Yeah, sure. So as we said, we're sort of estimating that if you take all the increases from COVID-related spending and all the decreases, you had a net $400 million. If you think about all those increases, it's not just PPP. There is supplemental pay, there is childcare, there is masks, there is food, there is more financial guards, and at our financial centers, you get all the PPP-related expenses, you've got all the tech expenses moving people -- virtually all our employees move from home -- moving to work from home. You've got some offsets, some sort of travel and other employee expenses in terms of meetings, that all kind of nets down this quarter to $400 million. We're going to work on that.

I don't think you can say it's all going to go away in Q3, but we're going to work on those expenses as we move forward. And of course, we're going to make sure anything we do, we're not jeopardizing the safety of our customers and employees. So, we think there is some opportunity there.

Q - Glenn Schorr {BIO 1881019 <GO>}

Okay. Last one, the wealth management reserve build, I wonder if you could talk about the profile of those loans, how much of that is to things like building for a wealthy individual [ph]that bets their corporation, just curious on what in wealth management we require that build?

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

I think, most of it's mortgages.

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

And there some commercial lending in there, but it's all very high quality and [ph]your personal people's loans and some are -- they were 30% of our mortgage originations this quarter, eight of the 22. And so, it's a significant mortgage book and that picks up some and they're just the estimates. Whether it happens or not, it's a separate question, but we feel good about that portfolio, but it's just the same factors apply to the rest of the portfolio as applied in that business.

Q - Glenn Schorr {BIO 1881019 <GO>}

Okay. Pretty (inaudible). Thanks.

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

And we look at things like real estate exposure. We consider real estate exposure in that business of people who have buildings and things [ph]like that, but there is some background to the many years, there is no hidden sort of real estate exposure on our wealth management business, it's handled as real estate.

Q - Glenn Schorr {BIO 1881019 <GO>}

Understood. Thanks, Brian.

Operator

Next question is from Mike Mayo with Wells Fargo. Please go ahead.

Q - Mike Mayo {BIO 1494617 <GO>}

Hey, Brian. You mentioned July activity is above last year. Is that right? So just a little bit more color on the green shoots, it seems like the trends are in your favor. But I'm just wondering if that's backward looking and many of your markets like Florida or Texas or California, I mean that's where you're big, you're seeing an increase in COVID cases and I guess that leads to death and that leads to shut down. So, from an on the ground perspective, do you expect these green shoots to continue? What advice do you give the [ph]governor of most states? How does it all shake out?

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

The first advice we give to everybody is try to be safe, the faster you can get the environment tip over, as you've seen in some of the hotspots we talked about last April, you can see the activity pick up. But just to be very precise, the data through July 14, so it's about as reasons you might be able to get, is up over last year. If you look in the first two weeks of July, it fell a little bit in Texas in places like that, but it's still 25% higher as a aggregate than where they were in the shutdown phase.

So it will plateau a little bit, Mike, I think and you'll see that ebb and flow, but there are other activities that just overwhelm that what you see in terms of the borrowers closing stuff, just the general activities, the improvement in people's homes, spending on the homes and you saw some of the data today that support that and the retail sales numbers.

So yeah, it's flattened a little bit because it had flattened in credit card, you'll see that more dramatically because the credit card spending goes on restaurants and travel and stuff, but just in the last couple of weeks, it fell mid single-digit percentages, I think, and some of those is Texas and Florida, but it's still 25% comparing that to the weeks before the reopening is 25% up. So, we'll see it play out, it's hard to be any more down the date to July 14.

Q - Mike Mayo {BIO 1494617 <GO>}

And then a separate question. I guess you've added more to you reserve, what $8 billion added to your reserves for the last two quarters, another $4 billion this quarter, pretty remarkable. And your net charge-off ratio was flat quarter-to-quarter. Talk about a disconnect; however, maybe it's not a disconnect. So I guess that's a tough question, but what would your charge-offs be? What would your NPAs be if you didn't have the forbearance in place? Like I believe it's ended tomorrow and you had to recognize the full extent of the problems, just in the sense of order of magnitude. Would it be 5% higher, 10% higher, 50% higher or what?

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

Just to give you a simple answer, if you and a lot of this, Mike, will always depend on timing. Because if you think about credit cards, then there is a roll rate to them as you well know. But just for the second quarter, I think the number would have been another $40 million higher, if you took all the stuff and assume the payment behavior took place, but there was no deferral. And so, it's $40 million [ph]on what $600 million, $700 million, but it's something small.

Interesting enough for the non-deferred customers, the delinquency quarter-to-quarter actually went down 15 to 20 basis points for the non-deferred customers -- excuse me, the non-deferred customers to 90% of people in card that didn't defer, their delinquency went down quarter-to-quarter. And so as you think about that, it's a mixed bag. The other thing that's inherent in your question is all of us getting used to seasonal versus the old methods of providing which is you provide for lifetime and then the losses are going to come debt later down the road, by definition or else you haven't had [ph]pieces of provision. So, you'll see the actual loss of this come in later in later quarters, but you're right.

Right now, we are seeing nothing that is consistent with a 11% unemployment rate in the actual consumer payment behavior and that has to do with the stimulus and things that it's helping that the margins quite substantially. So, it's hard to predict because there's a lot of factors in it, but that's kind of the data points I give you to give you a sense of it.

Q - Mike Mayo {BIO 1494617 <GO>}

And just last follow-up. I mean, clearly the stock market, based on your stock price doesn't believe you. I think your customers are a lot weaker. Are we just not seeing it yet? I mean, two or three quarters now, if they are lot worse than we expected? Or do you think that's going to play out in that like actually the borrowers are in better shape than people realize?

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

I think part of this will play out in terms of how the path forward on pace for stimulus and everything occurs. But even on the commercial side, if you look, the NPLs went up $350 million or something on the commercial NPLs for the quarter and 40 basis points. So even on the commercial side, we went through. We asked our team to go through every commercial bar in our business banking and our middle market segment, which is 10s of thousands of borrowers and assess every one and re-rate and make sure they're all up-to-date, make sure that you just really go, work on it when they were at home and not able to do as much, and they've gone through that book and what you see criticized moved up and that's expected, the actual non-performers aren't. And so, yeah, those commercial customers are adapting and you're seeing it.

So, I think, we basically look at the assessment of provision setting methodology as we said 10% unemployment year end, 9% first half of next year gets down to 7.5%, so it's not a rosy picture in a lot of ways, but -- and the proof is we give all this data to the Fed, as Paul said, and they do a stress test, and under those scenarios, our losses run, I don't know, 4%, 4.7%, and we're set with 2% of reserves today, and if we're not in that scenario in terms of actual payment behavior by customers or delinquencies and cash net has to do with it. The stimulus is different in this crisis than it's ever been. It was given directly to consumers to sustain their ability to carry their day-to-day expenses.

Q - Mike Mayo {BIO 1494617 <GO>}

All right, thank you.

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

It's obviously...

Q - Mike Mayo {BIO 1494617 <GO>}

Yeah.

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

Hey, Mike, it's obviously hard to see data yet. Right? But there are some clues out there. And you can start looking at those clues across the industry, and I would -- you mentioned one of them. Let's just look at losses. You can look at NPL growth. You can look at reserve quick growth. And then, as Brian just said, I mean it's not like this is one-time where our loss ratios in the Fed's stress tests have been the lowest among peers. They've done eight exams. Every one of those examples is kind of different. They did this thing in that one stress, this thing more on that other one, and change something else in the next one. Seven out of eight of them, no matter what they changed, no matter what they did, we have the lowest loss rates. So, there is some evidence out there if you look carefully at it.

Q - Mike Mayo {BIO 1494617 <GO>}

All right. Thanks, again.

Operator

Next question is from Jim Mitchell with Seaport Global. Please go ahead.

Q - Jim Mitchell {BIO 1972127 <GO>}

Hey, good morning. Maybe, Brian, just a follow-up on your corporate credit comment. If you look at your NPLs, you absolutely had the least amount of increase quarter-over-quarter versus your peers. And I appreciate your comments that you did really a real micro as opposed to macro look at every individual loan. So when we think about that, do you think if your performance has more to do with the fact that you took a micro look rather than some peers maybe doing a macro look? Or is it really just you're at higher exposure in investment grade, your industry mix? And how do you think about the massive amount of capital raising in the second quarter and the liquidity that provides the corporate borrowers and how you factored that? Just that's it, thanks.

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

I'm not sure where it is in that sequence. But the latter part of it, which is that -- basically the quality portfolio start commercial real estate exposure, as Paul said earlier, is much -- it's not going into last crisis, we had $14 billion or something of construction-related for [ph]housing construct. We had like $400 million or something like that, a very little, so the kinds of exposure to get pulled on pretty quickly.

And remember, we took a lot of charge-offs in the first quarter for gas company exposure, a couple hundred million fall, and those -- so, we've been taking care of the portfolio. So, it's not a matter of micro, it's actually just the quality of what we have done in client selection across the last decade gets us there.

And so -- and that's why you see differences in the rates in the stress test and other things, but that's responsible growth when we built this company, so there would be adamantine in all times and fortress, and that's how we build it, and we'll see where this all goes, but remember that our SEB is under the floor, it losses -- and there is a lot of objective third-party evidence that shows and it has a lot to do with our mix of businesses and how we build them.

Q - Jim Mitchell {BIO 1972127 <GO>}

Yeah, absolutely. And then, maybe on the deposit growth, it continues to be I think surprisingly strong, appreciate the comments. I'm not sure how it holds up and you're holding it in cash for now. But when you think about, is there any kind of trends throughout the quarter as the stimulus money got paid? Do you see deposit growth slowing or are you seeing it turn negative lately? How do we think about the ability for those at least near term? What are you seeing in terms of deposits over the last month?

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

Well, I'll let Paul talk about this in the commercial side especially, because he used to run that business for us a long time ago before he got in to be CFO, but the reality is the place where uncertain is in the large cash inflows from corporate customers that you're not sure when they're going to start using the money and redeploy the money and you want them to be frankly. We should want them to redeploy that money into the economy as opposed to having drawn or raised money in the markets and have it sitting on the balance sheet.

So that's the real volatility question is when do they -- when do those companies move some money out for higher yield, because, yes, when the money market spreads to settle in hand with a little more yield to them and things like that and the stability allows them to take, think about putting it off a bank balance sheet, so that's the volatility question in terms of deposits is around that.

But we look at consumer, just to give you a sense, the linked quarter growth in consumer checking was $50 billion. We had 108,000 net new checking accounts, year-over-year up almost 900,000. Those are numbers that are normal quarter sort of net production. I think we might have been 250 or something like that in a quarter like this.

And so, what's happened is we still are building up that core consumer base and the average amount in accounts were up 12%, 20%. Some of that's been spent down. We think all the EIP-type stimulus is largely out of people's accounts, it's been gone through the system. Obviously, the unemployment supplements for the limited number of customers we have. That's a small -- in any group, that's 10% of population, so it's smaller than the whole, but you're seeing that stimulus was that $1,200 type stimulus came in, went out of people's accounts pretty much. On the small business, you're seeing the PPP, 65% to be spent, which is also good because that's future stimulus to be deployed.

And so, if you think about all those pieces, I would focus more on Paul's comments about understanding whether it's deposit going to stick is more of a commercial question and a large corporate question that it is a wealth management consumer question, because what's going on behind this as we've ground out another, even 40% of our branches shut down due to the environment, we have ground out digital sales and digital growth and even non-digital growth to the tune of 108,000 new core checking accounts with average balance moving up 92% core. And that's ticked your ribs money and we'll deploy that over time.

But you had to make sure that, like all of you are worried about where we go next, and that's why we're trying to keep the liquidity position that might run out of here for the clients purposes or whatever. So, Paul, [ph]would add, I think, all the volatility comments really around the institutional side.

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

Yeah, I'm not sure I had anything, Brian. Maybe just a macro point of. Obviously, if the money supply grows, our deposit balances are going to go up and when you look at -- in addition, when you look at the treasury's bank account at the Fed, it's got an enormous balance way higher than usual, and I guess if some of that's going to end in the private sector as well.

So, there were perhaps some macro forces that would suggest that deposit balances are going to grow at banks and we're going to get our fair share. There are a couple of little just tiny things about the third quarter that's worth reminding people. Tax payments were delayed, and they're going to get paid in the third quarter, plus we're all hoping, as Brian says, it's spending continues to increase and so some of that excess money that's sitting in people's accounts may get spent both on the corporate and consumer side, and then in GWIM, you've just got -- a lot of deposits came out of the market and went into deposit accounts and the markets continue to feel good to people, you expect to see some of that come out of deposit and go back into the market.

Q - Jim Mitchell {BIO 1972127 <GO>}

All right, that's all, really helpful. Thanks.

Operator

Our next question is from Betsy Graseck with Morgan Stanley. Please go ahead.

Q - Betsy Graseck {BIO 4799503 <GO>}

Hi, good morning. Couple of follow-ups there. One on the point you were making about the deposits, interesting that you had all of those drawdowns and paybacks, but the deposits didn't leave yet, that's basically what you're referring to, right?

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

Yes, that's yes, that's the interesting point you would expect. If they paid them back, you've seen it, but other cash came into those companies and they came on the books, and I think we grabbed more than our fair share, that has nothing to do with the consumer side, but on the institutional side, it's been interesting what our predictions would have been, that we have seen the deposits of client already and they have it.

Q - Betsy Graseck {BIO 4799503 <GO>}

So, my two questions. One is on just the forbearance in the waivers. Can you give us an update as to how you're dealing with those? Do they roll off automatically? Are you going person by person? How should I be modeling this fee waiver stating? Is it going to come back? Do you get back in? And do you stop the fee waivers in 3Q? Or is it going to be more of a phase in through 2021? Just help us understand how you're dealing with that.

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

I think, leave aside mortgage, it has different aspects because of statutes and stuff, the rest of the lending side stuff begins to, especially like the small business as I said earlier, really runs off as we speak, and then some of the other products run through. We're always going to help consumers in distress. So if somebody calls up and says, I'm unemployed and I can't work and stuff, we're going to work with them and we're going to work both on the fee side and on the collection side for lack of better term.

But our view from the start was we want to have that dialog with the consumer to help figure out where they stand, and so, that activity starts to pick up. The waivers by definition were 90 days and things they roll off, but what you'll get away from is people who did it out of panic, which when you see, some has paid every month, obviously they didn't need the waiver. Those people roll off and disappear and you get down to the people that you need to actually help, they're unemployed and struggling and we'll help them. We'll work with them, like we always do in our collection efforts.

So, that's the sort of credit side of the thing, and in the big numbers and move, the numbers of requests, I said, have dropped 98%. So, it's really nothing, if you look at our percentages relative to the industry and mortgage, we're lower across the board 200 basis points, 150 basis points in terms of requests and stuff. So we feel good about that.

When you get to the fees, this is really going to come down to this. We went into this thinking about it as a bit of a natural disaster type approach [ph]obviously, so that's going to come down to where the consumer lives, the market condition, what's going on in that market, and whether they are able to work and things like that. So, we'll see that play out. If there is another round of stimulus payments, we waive the fees that people wouldn't have the fees, we've held off on the fees that they had, that could have a negative in account to make sure they got the whole 1,200 in the case of the last payment.

We will do that again, because that's the right thing to do to make sure they get the benefits of those payments. But those things will sort of ease through the third quarter depending on really a specific question, and then as you get towards next year, they're normalized.

Q - Betsy Graseck {BIO 4799503 <GO>}

And then, as we go through this pandemic obviously, we've got flash points building again in certain locations, like you were asked earlier on the call, you've got a big footprint of branches in these locations. So I would think that your programs are open obviously for folks who are coming back into that second wave. I just want to confirm that.

And then, how are you thinking about the branch footprint just generally? I mean, you mentioned earlier about opportunities to improve efficiencies, to call back to $400 million net COVID cost increase that you experienced this quarter. But a little bit longer term given the increase in digital, the fast ramp that we've seen in the most recent couple of months. Does that make you think, hey, we can pull back on our branches even more than we had been thinking before? Give us an update there. Thanks.

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

Yeah, I think the time to figure that out will be a little bit later. That's not because we don't work at all times. Even year-over-year, I think, we're down 30 or 40 branches or something like that in terms of branch count. This last year second quarter, this year segment, we're always working as dynamic. There might be bigger and replaced two or three small ones, they might be places that we just had too many whatever, but we will always be working that. So, 6,100 to 4,300 branches continue to work at. And we're doing that by following customer behavior. So, this is some of the behavior changes stick to the ribs, you'll see us keep fine tuning our system.

By the way, the cost of deposits, no, it's all the operating cost in consumer over deposits actually went down year-over-year again to be up by about 7 basis points or something like that, so we continue to manage our overall operating costs down and it's not just the branches, it's all of the call centers and other things around it. So let us play that out. I don't think, and then by the way, remember we're deploying and we opened branches in the middle of this thing and places in Ohio and stuff we didn't have, so that replaces on the comp at a much different execution than something that may have been left over from years ago.

So [ph]it is a play out. I don't think you'll get to go one way or the other way dramatically, but what will happen is some of the count, we believe, will be consolidated markets as we've always been doing and deploy the markets where we don't have reach. I think on a given day we're still getting the 0.5 million business in the branches, so it is an important part of what we do and the teammates in those branches have done incredible work being open everyday during this crisis, despite what was going on in the environment around them.

So, they will always be important. It's incredibly an important part, which makes us different. We are a big digital company and would have been a physical company and that combination produced superior customer reach and results.

Q - Betsy Graseck {BIO 4799503 <GO>}

Thanks.

Operator

We'll go next to Matt O'Connor with Deutsche Bank. Please go ahead.

Q - Matt O'Connor

Good morning. Can you just talk about the small business PPP in terms of the timing of when you think it will be repaid or forgiven, and remind us the accounting there, and is that included in your net interest income outlook?Thanks.

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

I want to start with the accounting. So, if you look at this quarter, there is about a little under $100 million, it will be a little more than that next quarter in NII for PPP, and that's a function of 1% interest rate plus and if that is under 1%, you got to amortize the fees into NII over the life of the loans.

In terms of the overall program, we did about 335,000 loans and it's in a few weeks. That was quite expensive in terms of all that we had to do that well. And so I would not expect much, if any profitability out of PPP.

Q - Matt O'Connor

Okay. And that include the fees that you get it has accelerated from a forbearance, I think there were some articles out there [ph]that are without any profit, but obviously, there is just a focus on the revenue and to your point, there is a cost as well, so.

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

Yeah, once there's forbearance to the extent we were amortizing those fees into NII, once a loan is forgiven, then you have to accelerate the remaining fees that haven't been amortized. So, it could be a spike in a quarter or two if we start seeing a lot of forbearance, but again, as you know we said we're going to donate profits, but I wouldn't expect a lot of profits, [ph]how this has programmed it. 335,000 loans in a quarter is probably, I don't know, I think somebody in consumer told me it was like 10 years of loans in small business. Well, this was a massive effort that involved people outside the company, in the company to get to do it well.

Q - Matt O'Connor

Okay, and then just separately on the criticized commercial loans, it's helpful that you did disclose this. I'm not sure everybody does, I appreciate that. But how would you think about the loss content on that? Obviously, it's a much bigger bucket and say non-performers and our loans that you are watching. But how should we kind of think about the risk of loans that are kind of criticized versus say it nonperforming or how much might flow into nonperformance?

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

Yeah, I think that depends on the loan that largely secured the collateralized, what sort of recovery, but remember the credit size, the ratings driven is a loss, probability of following the loss given default and then the collateral structure. So, that's all built into the reserving methodology that results in the reserve build. So it's not something that you have to think of separately than NPLs. It's just, there are different stages in the process of getting through the system.

But, so it's really -- you have to say if it's -- for example, we have a lot of retailers have gone through bankruptcy over the last several years. We haven't lost any because of the net debt securing yourself and things like that, but that's a business we've had for decades that has done a great job there, whereas it's an unsecured line in somebody to have fallen, so it may fall as quickly that can be more problematic, but it's just rest assured, it's all built into the methodology producing the loss content versus the reserves, which is in the center as we use.

Q - Matt O'Connor

Okay, thank you.

Operator

Next question is from Ken Usdin with Jefferies. Please go ahead.

Q - Ken Usdin {BIO 3363625 <GO>}

Thanks, good morning. I had a couple of questions on the JV dissolution. So I was wondering, Paul, relative to your $100 million fees, first of all, where is it located kind of where are we going to see it. And second of all, can you help us give a perspective of what it was maybe at its peak, and you mentioned it could get better as the economy improves, what's the best metric we can watch out of your disclosures to track of that progress?

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

It's a portion of that revenue is going to be in consumer, a portion of it's going to be in global banking. We got to think about how to help you see it, because it's never certainly on net basis, it's never was a big number in terms of net profits coming out of that JV. We expect it now that we can integrate it, do it our way, really leverage our customer relationships, put our full sales force more directly behind it, and innovate. We think this is incredibly important to our customers and we can grow it, but right now, it's -- we gave you -- I think we gave you some perspective, it's about -- I would expect the revenues there to be about $100 million in the near term. But we would expect them to grow as we ramp up some of their own investments start to bear fruit. And again, I don't know how to answer your question on how you can see it up to think about that, whether there is something appropriate to put the supplement or not.

Q - Ken Usdin {BIO 3363625 <GO>}

Okay. And just in terms of fees, other categories, wealth management, the asset management part was down. Was that because of the averaging effect and should that improve given the period end market levels that we saw?

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

Yeah, you have to remember that AUM fees are on a one -month lag. So you're picking up there, what happened at the end of the first quarter.

Q - Ken Usdin {BIO 3363625 <GO>}

Yeah. And lastly, just any comments about the investment banking pipeline given the relative strength that we saw in the second quarter? Thanks, Paul.

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

Yeah, sure. The investment banking had a great, great quarter. And we know we picked up significant market share. We've been picking up significant market share for many quarters now. I think all of you sort of recognized that. It was a record. I think our market share is above 8% at this point, and our market share in middle market investment banking is also rising given our emphasis there on the bankers we had, I think we're up to over 9% there.

A lot of activity as we help clients raise capital to address their needs. You can't really expect, I don't -- we don't know the answer, but we already sort of seen a little bit of a slowdown in activity in the first couple of weeks of this quarter. So I don't think you can expect that the third quarter is going to be as robust as the second quarter has been.

But I will want to emphasize we feel really good about the progress we have made with our clients in terms of market share both for large companies around the world and middle market companies.

Operator

Thank you, we'll go next to Saul Martinez. Please go ahead, your line is open.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi, good morning, guys. I wanted to start off on NII to just have a bit of a clarification. You said NII would be down couple hundred million quarter-on-quarter on a commercial paydowns. You also said that long end rates would also weigh on NII. Just if you could give us a sense of what the order magnitude could be in terms of additional NII pressure to the third quarter from long end rates? I would assume that the redeployment of cash into securities or something that helps, but only over a longer period of time, and [ph]then as your recall in the past, we've talked about reinvestment risk and kind of sized up the impact of longing rates on securities cash flow. So if you can help us understand that the potential impacts on third quarter, how to think about it beyond that?

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

Yeah, look, I will say in terms of our $200 million kind of suspected being down quarter-over-quarter, 2Q to 3Q, we're kind of putting all that stuff in there, right?

Q - Saul Martinez {BIO 5811266 <GO>}

Yeah.

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

Loans being potentially down, you've got average LIBOR coming down, you've got the securities portfolio. It's kind of all in there.

Securities portfolio, about $20 billion, $25 billion matures every quarter and reinvestment yields right now are significantly below where that one of the portfolio is. So that's just going to slowly dilute over time. We can offset some of that if we decide to take these deposits for the now sitting in cash and put them into securities. We can get sort of a natural offset, but we have to sort of just see how that all plays out.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. [ph]I think I misunderstood. I thought you meant, so the $200 million, a couple hundred million is all weighing up not simply from the impact of commercial paydowns or from a number of things, I guess. I just I wanted to go back and follow up on Matt's question on PPP and get a little bit better sense for what the order of magnitude of the impact would be, because I mean you have $25 billion PPP loans and I think it's fair to assume that a pretty sizable proportion of those will be forgiven. And given the fee rates on those, I mean, we're not talking about small numbers even relative to the size of your NII get to easily over $1 billion.

So I guess my first question is, why should we see a pretty significant spike in NII in 4Q and 1Q is, as those loans start to get forgiven and the income is recognized and I guess relatedly on the expenses, I guess I'm trying to understand [ph]what need, but you're not going to make a lot of money on that, is it just that it's sort of in the expense base already and you've had a [ph]rare set of expenses or is that is revenues are recognized from an accounting standpoint, you'll donate those accounting -- that accounting revenue [ph]whereas it is one year competitors is doing. I guess I'm trying to understand the order of magnitude, timing, and geography of the past, they don't seem to be small.

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

We announced, in April, I think it was that we give away the net profits from this activity. There's a lot of internal costs, obviously allocation of 10,000 people we had working on the origination [ph]path, onto this to the high point. That forgiveness what -- we have got 3,000 people lined up to work on forgiveness that are already working on it and we hope for business in a couple of weeks, and then we had -- in part, we also had higher third parties come and do some work and supplemented them. So there is a lot of elements.

So where shows up in revenue and expense, we'll deal with it, but just -- while the revenue you're saying is not insignificant, the issues, there is a lot of cost against it. We've somewhere in the P&L and some are going to be next quarter's P&L, because on the forgiveness side we have these teammates working on it. So we'll reconcile it up for you, but the base to commitment was to give away the net profit, that was something we committed in April. This is not new news.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. But I am thinking about (inaudible) (Multiple Speakers).

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

You're not going to see -- to your point on the revenue, you're not going to see it in the revenue until the loans start to get forgiven.

Q - Saul Martinez {BIO 5811266 <GO>}

Yeah, which we would assume (inaudible)

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

We don't know what it's going to be.

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

[ph]Yeah. And one of the ways in phase 4, they talk about extending and doing more loans and there is a bunch of proposals. So, a little bit it's hard to predict because if they --

so you can do with loan A and to do another loan or extend it, you've debt. Even in the last quarter, we are going from eight weeks to 12 weeks, 24 weeks, and things like that. So, there is no mystery here with us. We just don't know until we get through what exactly is going to happen, because the rules changed so much.

Q - Saul Martinez {BIO 5811266 <GO>}

Yeah. Okay, all right, fair enough. I appreciate it.

Operator

The next question is from Vivek Juneja with JPMorgan. Please go ahead.

Q - Vivek Juneja {BIO 1505553 <GO>}

Hey, Brian. Hey, Paul. A question that I wanted to just clarify. The consumer loans that have been deferred, I'm presuming and the sort of late June, early July, you're starting to see some of those start to get through their deferral periods, just deferrals on 90 days. And so what are you seeing in the ones where deferrals have done? What percentage are re-upping and asking for a deferral to continue versus how many are going off? And of those going off, what are you seeing?

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

We're not -- to your point, Vivek, is that we are sort of -- it's now the time for that. It all kind of the time period that most of it occurred is now in a time period where it rolls off, and so, we'll know better, but yes, separate the card, we've already seen a couple hundred thousands roll off in a bunch of rolling up as we speak. So that is 85% of our card and to separate that from the standpoint of all the other aspects. What I said earlier about small business, which is the next biggest -- which is the biggest percentage category. Those are docks and Dennis scenario if they've all told us they're paying us and their payments are not coming up in July and early August.

In terms of home loans, we're seeing the numbers on deferral drop every week, because the new request are less than people who've continued to pay. And so, it's going to come down to cards and we're in that period of time, but there are substantial reserves set up based on the credit characteristics of those individual part holders and what our expected outcome for them are.

And as we said earlier, a lot of them, substantial number have been paying us every month, some haven't been paying us at all, some of them paying us part loan, and that all play out this quarter.

When they charge-off with them, it will be down as that plays out over the roll rate type of thing, but it's all in the reserves today. There is a decent chunk of reserves in the car business out that is specifically built by these deferred loans.

What I said earlier, and if you didn't hear it, was that for the second quarter, for the people who have deferred, the actual increase in charge-offs would have been about $30 million, $40 million on a basis [ph]to $600 million, $700 million whatever it is, so it wasn't a substantial difference yet. And so, those are the people [ph]that only got enough that they were rolled and charge-offs during the quarter.

So, let us see it play out. It's in the reserves and will be covered by the reserves.

Q - Vivek Juneja {BIO 1505553 <GO>}

Okay, thanks.

Operator

Our next question is from Brian Kleinhanzl with KBW. Please go ahead.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Yes, thanks. Just two quick questions. I mean, first on the expenses, just how we should be thinking about the expense trajectory as we look out to the third quarter, fourth quarter. I get the extra $200 million from merchant services, but then how much of these COVID-type expenses are expected to roll off into the third quarter and then still we get the typical seasonality as well in the back half of the year?

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

Yeah. So all those factors, I think, Paul laid out earlier. But what we were mining people's last year when we unwind the joint venture and I told you about it, at this time last year we said when we took it from a joint venture interest through the P&L on the balance sheet interest, it was going to increase our expenses that $200 million, this is the quarter where it happens and so we just want to make sure people are factoring that in.

Absent that, you know that we managed expenses tightly in this company and we'll manage them down and we'll have some pluses and minuses and we'll work at them, but we didn't want people forget that we told you that last year.

All the rest will be the same sort of management practice we had. You have some PPP expenses, you've come down a little bit. You have -- as people moved around, opened up a little bit, you have a little more business to activity expenses. We'll see it play out, but then you have the seasonality as you mentioned, and it will all be standard fare. But the key difference is we want to make sure people didn't forget what we told you last year.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Okay, and then [ph]it's just simple is the tax rate guide that you gave in second half, does that roll forward into 2021? Thanks.

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

I don't think we have a good [ph]answer for 2021 yet. At least, I don't have an answer. We can get back to you on that if you need it. But for the rest of the year, it'd be around 11%.

Q - Brian Kleinhanzl {BIO 15228405 <GO>}

Okay. thanks.

Operator

And we'll take our final question today from Charles Peabody with Portales. Please go ahead.

Q - Charles Peabody {BIO 2346511 <GO>}

Yeah, I wanted to get some more color on your consumer and community bank, and particularly the profitability of the various product lines like cards, mortgages, autos, branching, and I ask that, because on a relative basis, your consumer and community bank has done much better than the other big three; Wells, JPMorgan and Citi. And I know a big part of it is probably cards where the other businesses are losing money -- the other companies are losing money in cards. So can you talk a little bit about the profitability of your different product lines and the relative value that they produce for you guys versus other major banks?

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

I'm not sure. I frankly agree with your premise that the profitability our consumer bank is driven by the deposit business. And so, given that you're in the middle of a twist right now with rate falling in the floors of zero rates in the consumer business, [ph]that acquired it to fell this quarter, but that would that be expected as you go through this twist. So, it's been running -- the deposit segment have been running $2 billion a quarter type of numbers. And that's in the consumer lending segment would have been running even back in '19 about $1 billion a quarter. So it's a business, which is -- and that's all lending, not just the card lending. So it's a business, which is driven by the deposit business and when the rates fell as quickly and we move rates down in the quarter, it's going to take a little lot of catch back up, but that's -- but I'm not sure I agree with the premise that is driven by the car business. The car business is a portion of that, third of the general operating profit.

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

I think you're right, Brian. I think the way to think about it is we started at a position of profitability before rates came down. That was strong and in many of our competitors, given the strength of our deposit franchise. And given how careful we have been, with respect to credit, unsecured consumer credit, we are now seeing us getting hurt on the -- because that deposit franchises, those deposit side is valuable in a low rate environment, but you've not seen us have the same sort of potential losses in an unsecured consumer, because we just don't have as much as others.

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

Yeah, be that as it may there, because the lending portion lost money this quarter and the deposit business didn't make money this quarter. So I'm not sure I get the starting point, but it's just to give you a sense, and so it wasn't a lot of money overall, but it was made by the deposit business.

Q - Charles Peabody {BIO 2346511 <GO>}

I guess the starting point was just that the card businesses tend to be an outsized product for the other big banks, and they clearly are losing money, and so is that the big differentiation? Is your card business losing money this quarter as well, but less so than the other big businesses, other big companies?

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

Yes. The lending business lost money. We don't -- I don't have a separate car P&L, but the lending business in consumer lost money, the deposit business made money and brought it to a profit and offset three quarters $1 billion of losses on the lending side, because of the provisions there versus three quarters of $1 billion of profit after tax. So, I remember what drives the profitability consumer business is the position we have across all the products. We don't think of the lending business and as we think of a customer business that is number one position in deposits, that 92% for checking account growth of 1 million accounts, year-over-year.

The average about those accounts growing year-over-year, even taking out the COVID impact that they were growing at double-digits typically in a year. The operating cost coming down year-over-year in terms of as a percentage of deposit. These are all good measures that give you a [ph]great thank to win where it gets tougher when rates are very low and we've played that. I've been CEO and this is my 11th year and [ph]I'm through 911. I think that the Fed's fund rate has basically been zero, the quarter and so that's we're doing.

The car business is a nice business. We keep it to size that we think is consistent with our [ph]adamanting commitment, responsible growth, and therefore, it's never going to drive the P&L one way or the other way, been a risk-adjusted margins at 8% in that business today during actual charge-offs. Remember what's causing the losses, you put up reserves for the rest of the life of the portfolio in one quarter given the economic scenario is deteriorated. So it's a good -- it's a wonderful business for us, it's our biggest business in terms of rofit, but we don't run it as a car business. We've home loan business, we got out of that, [ph]many of it's a decade ago, so it is a consumer business and we drive our unified base.

Q - Charles Peabody {BIO 2346511 <GO>}

Thank you.

Operator

It appears we have no further questions. I'll return the floor to Brian for closing remarks.

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

Well, thank you, and thank you for spending time with us this morning. It's another quarter we've driven responsible growth. We continue to manage this company tightly given the environment we're in, and we continue to drive the core activities forward, and in this quarter, we are especially pleased with the work our team did in global markets and investment banking area that are gaining share and providing the earnings power to have a sort of twice our dividend build our capital, build our liquidity, and have a -- in the worst economic quarters, it's a great depression. So, thank you. We will talk to you next quarter.

Operator

This will conclude today's program. Thank you for your participation. You may now disconnect.
