Operator

Good day, everyone, and welcome to today's program. At this time all participants are in listen-only mode. Later you will have the opportunity to ask questions during the question-and-answer session. [Operator Instructions] Please note this call is being recorded.

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

Lee McEntire

Good morning. Thanks to everybody on the phone as well as the webcast for joining us this morning for the Third Quarter 2016 Results. Hopefully everybody's had a chance to review the earnings release documents that were available on the website.

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

One thing before Brian and Paul get into the results, I just want to remind you we file an 8-K on October 4, giving notification the company changed our method of accounting for the amortization of premium and accretion of discounts related to certain debt securities known by the investment community as FAS 91. Our change to the contractual method which is used by the just majority of our peers will provide better comparability of our results.

As a result to the change, we restated our historical results, and provided the historically restated information in the 8-K and our earnings materials today naturally reflect those restatements.

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

Brian Moynihan

Thank you, Lee. Good morning, everyone, and thank you for joining us today to review our third quarter results. Our results this quarter continue our progress on our long term strategy. We continue to drive responsible growth and deliver more of the company's capabilities to our clients and customers. This progress is becoming clear with each successive quarter, and you can see the highlights of that on slide 2.

We reported earnings of $5 billion or $0.41 per diluted share and EPS improvement of 8% from the year ago quarter. We improved operating leverage across the businesses, utilizing technology to lower costs and improve our processes. Our pretax earnings improved 17% compared to the third quarter of 2015. This pretax earnings comparison is important as it eliminates the unusual movements in the tax line like this quarters' tax charge and the UK corporate tax rate change.

Like last quarter, I thought I'd address a few topics before hearing from all of you. To do that, let's look at slide 3 and 4 of the earnings material. The first question is, are we making progress driving our responsible growth strategy? Yes, we continue to show progress throughout all the businesses. Our revenue growth has more clarity as we move past the periods of significant impacts from implementing regulations, running off non-core portfolios, and divesting non-core businesses.

Revenue grew 3% over the third quarter of last year. Behind that improvement is our continued investment in this great franchise, in our sales teams, in our technology across the board. These sales teams and the buildup we've been doing there help us to increase our capacity to serve our customers and clients.

An example of that is in our consumer business, they are focused on being the core bank to all our households. This has resulted in fewer checking accounts than we had years ago, but the average balance of the checking accounts we have has doubled and they are now roughly $65 to $100 per account. You can also see this in the growth of our Merrill Edge brokerage balances, which now total over $138 billion, adding investment relationships to the mass market customer base.

In general, consumers are deepening their relationships with us, as they use our straight forward investing tools to get them started on a path to investing. For affluent and wealthy customers, our customer progress also continues. Our global wealth and investment management teams, US Trust and Merrill Lynch not only manage $2 trillion plus in investment balances, but also manage nearly $150 billion in loans and more than $250 billion in deposits, and we continue to see net flows of core assets in that business.

On the commercial side, clients continue to respond to our universal banking model for a simplified stuff for financing, investing, and advisory services. We will continue to operate within in our established risk framework in defined customer groups and we aren't reaching for growth. This would drive more sustainable results over a longer period of time for our shareholders.

And then with our global peers restructuring, including in the markets business, I think this quarter is another great example of how global markets business is important to our investing and issuing clients. We better client activity driving the best third quarter results we've had in the five years in investment banking and in sales and trading, and we are doing that with a smaller balance sheet, fewer people, and lower value at risk or VAR.

So growth in deepening, all consistent with our responsible growth strategy continues across all the customer bases. Paul will talk to you more about the statistics and its successes. Another question that we get asked is can credit remain this strong? Well many of you asked that last quarter and the quarter before that and the quarter before that. And in this quarter, it's still got better again with our charge-off ratio decline to 40 basis points this quarter at an historic low.

This is driven by changes we made right after the crisis, thinking 2008 and 2009 and the long term benefits of that effort continue to come through. And by the way, sticking to our responsible growth strategy, even as times have been relatively better.

US consumer health is generally good. Over the past few quarters, exposures in our oil and gas that were causing industry concerns for commercial losses have improved, and charge-offs have receded. Other commercial credit remains very strong and Paul will touch on these topics later.

Another question we get asked is, what can we do to drive earnings even if we stay in this low rate, low growth environment? We aren't waiting for interest rates to rise here at Bank of America. We are driving our earnings growth now. We work on the things that we can control, expenses, loan and deposit growth, and fee growth.

Long-term rates are down compared to last year, yet earnings have grown. Despite that, net interest income is up 3% from third quarter '15, while net interest yield has been stable because we grew core loans and deposits. Paul will take you through the loan growth details later, but I want to pause a moment and talk about our deposit growth.

Deposits are core part of what drives our franchise earnings. We have 1.2 trillion of deposits that's proof the customers entrust us to safeguard their money. We are heavily weighted and mix those deposits towards consumers, whether they are general consumers or wealthy consumers. This in turn provides a very stable base of funding for the company and allows us to be less relied on the markets we are funding.

Nearly $450 billion or 36% of our deposits are non-interest bearing, a very strong mix. Deposits on average grew $68 billion year-over-year or 6%. The teams have done tremendous work here, and this quarter wasn't an anomaly. This is the fourth quarter consecutive quarter where we have grown deposits more than $50 billion over the previous year.

Our commercial teams remain focused on growing deposits also. They're growing deposits that are LCR friendly and doing great work with our industry leading cash management capabilities. As a result, year-over-year global banking grew their deposits 3% to 300 billion.

Our consumer and wealth management teams combine have $860 billion in deposits. They grew this large base by 8% in the past 12 months. For the first time, consumer tops $600 billion in deposits. These deposits are growing because our capabilities in the business are the best in the industry and our customers and clients see that. Whether it's our 21 million plus mobile banking customers, our 34 million plus online customers, or the more than 5 million customers that come in to our financial centers every week. These customers show that they appreciate the capabilities and integration of our network.

So when we look at what else we can do to control and drive earnings in a low growth environment, we get asked a lot about expenses and can those expenses keep being driven down and go lower. Well the answer is yes. Last quarter we gave you a 2018 expense target and we continue to make progress towards that.

Our expenses declined 3% from the third quarter of 2015 to 2016. Our efficiency ratio improved 60% to 62% this quarter that is a 400 basis points improvement from last year's third quarter. We continue to deliver expense reductions while continuing to invest in technology and sales teams and other matters are important for the futures franchise.

After taking in to account the addition of large bank FDIC assessment at the start of this quarter, expenses are also down on linked quarter basis, even as we continue to invest and absorb all the severance, regulatory, resolution planning and other repositioning cost to continue to reduce our operating cost.

We have been innovating in technology and will continue to do so to improve processes and eliminate the need for paper and humans handling that paper. Our simplified and improved initiatives continue to help drive those costs down, and that leads to the question we also get asked. Can we deliver and sustain returns above our cost of capital?

As Lee talked about earlier, we restate our results to change under FAS 91 and reduce the variability and make us more comparable to peers. As you can see that makes a little easier to see the longer term return on tangible common equity trends. This quarter we reported 10.3% and it is now stabilized above the cost of capital even given our larger and larger capital base.

We still have work to do here to drive to our ultimate goals, and this quarter is another strong step in that direction. And importantly on slide 4, you can see that each business has improved its leverage. They grew their earnings, had strong efficiency and return far above the cost of capital. And all that continues to bode as we look ahead.

So as we look forward, we are driving responsible growth and maintaining discipline on cost, and this has allowed us to deliver more capital back to you, and we'll keep on doing that.

Now let me turn it over to Paul to cover the numbers. Paul?

Paul Donofrio

Thanks Brian. Good morning everybody. Since Brian covered the income statement highlights, I will start with the balance sheet on page 5. Strong deposit growth drove a small increase in the size of our balance sheet versus Q2. Deposits rose 17 billion or 6% on an annualized basis.

During the quarter, long term debt fell by 5 billion. We put cash to work growing securities in our investment portfolio and more modestly through loan growth. Global equity sources rose driven by the positive growth, and we remain well compliant with LCR requirements. Tangible common equity of 174 billion improved by 2.8 billion from Q2, driven by earnings.

In the process, we returned 2.2 billion to common shareholders through a combination of dividends and 1.4 billion in share repurchases. On a per share basis, tangible book value increased to $17.14, up $1.60 or 11% from Q3 '15. I would note that this increase was driven by both retained earnings, as well as share repurchases below tangible book value as we reduced shares 3% from Q3, '15.

Turning to regulatory metrics, as a reminder we report capital under the advanced approaches. Our CET 1 transition ratio under Basel III end of the quarter at 11%. On a fully phased-in basis, CET 1 capital improved $4 billion to $166 billion. Under the advanced approaches compared to Q2 '16, our CET 1 ratio increased 40 basis points to 10.9% and is well above our 10%, 2019 requirement. RWA declined roughly 20 billion, driven by reductions in global markets exposures and improvements in credit quality, driven by run-off of non-core legacy exposure.

We also improved our capital metrics under the standardized approach. Here, our CET 1 ratio improved to 11.8%. Supplementary leverage ratios for both parent and bank continue to exceed US regulatory minimums to take effect in 2018.

Turning to slide 6. On an average basis, total loans were up 23 billion or 3% from Q3 2015. And while up from Q2 ’16, growth was at a slower pace. Consistent with past periods, we break out loans in our business segments and in all other. Year-over-year, loans in all other were down $30 billion, driven by continued run-off of first and second lien mortgages, while loans in our business segments were up $53 billion or 7%.

In consumer banking, we continue to see growth in residential real estate and vehicle lending offset somewhat by home equity pay-downs, which continued to outpace originations. In wealth management, we saw growth in residential real estate and structured lending.

Global banking loans were up 26 billion or 8% year-over-year. On the bottom right of the chart, note the growth of 68 billion in average deposits that Brian mentioned.

Turning to asset quality on slide 7, we believe a number of factors including our strategy of responsible growth, enhanced underwriting standards since 2008, and a healthier economy have transformed the risk profile of Bank of America, as we look forward to future economic cycles.

Total net charge-offs of 888 million improved 97 million from Q2. Consumer losses declined across a number of products and commercial losses also declined, driven by lower energy losses. Driven by these improvements, provision expense of 850 million declined 126 million from Q2. We had a small overall net reserve release in the quarter as consumer real estate releases more than offset bills and other products.

On slide 8, we provide credit quality data on our consumer portfolio. We remain focused on originating consumer loans with borrowers with high FICO scores and our asset quality remained strong. Net charge-offs declined 71 million from Q2. This improvement was broadbased across consumer real estate as well as credit card.

Note that credit cards account for more than two-thirds of losses in our consumer portfolio, and within our US credit card book, the loss rate improved to 2.45%. NPLs improved and reserve coverage remained strong. Moving to commercial credit on slide 9, net charge-offs of 110 million improved 26 million from Q2. With respect to energy, exposures are down, losses improved, oil prices have stabilized and we have $1 billion of reserves. More specifically, energy charge-offs of 45 billion decreased 34 billion from Q2.

While reservable criticized declined from Q2, we did experience an increase in NPLs this quarter, which concentrated with two clients, one in metals and mining and one in energy. Overall, our commercial portfolio continues to perform well.

As I shared with you last quarter, the metrics in the commercial portfolio speak for themselves in terms of quality and performance. The reservable criticized exposure declined and as a percentage of loans remains low. The commercial net charge-off ratio is 10 basis points. Excluding small business it is 5 basis points and it has been around 15 basis points or better for 15 consecutive quarters. And the NPL ratio remains low at 45 basis points.

Turning to slide 10, net interest income on a GAAP non-FTE basis was 10.2 billion, 10.4 billion on an FTE basis. As Lee mentioned earlier, we changed our accounting method for the amortization of premium or discount paid on certain of our debt securities from the prepayment method to the contractual method. The contractual method is used by our peers and should make it easier for investors to make comparisons.

Compared to Q3; ‘15, NII is up 3 million or 3%, as loan growth are shorter than rates and higher security balances funded by deposits more than offset the negative impact of generally lower long-end rates over the past several quarters.

Okay with respect to assets sensitivity as of 9/30, an instantaneous 100 basis point parallel increase in rates is estimated to increase NII by 5.3 billion over the subsequent 12 months. This is lower than the sensitivity we reported at June 30. The reduction was mostly on the long end, driven by the change to the contractual method and slower prepaid speed based upon on recent trends in customer behavior. Note that this sensitivity on the short end at 3.3 billion has not changed significantly.

Turning to slide 11, non-interest expense was 13.5 billion, that $0.5 billion lower or 3% lower than Q3 ’15 driven cost reductions across the company. This is the initial quota of the increased FDIC assessment to show off the deposit insurance fund, the increase in expense for us is roughly a $100 million per quarter.

Compared to Q2 ’16, expenses were stable, as good core expense control was offset by the higher FDIC cost and modestly higher incentives. Q3 litigation expense was 250 million, which is fairly consistent with both

Q3, ’15 as well as Q2 ’16. Most expense categories were lower year-over-year. This trend was led by personnel expense, which includes the Q4 ’15 exploration of the full amortized advisor awards in wealth management. The rest of the improvement was driven by reduced cost of mortgage servicing coupled with same efforts in other initiatives. Our employee base is down 3% from Q2 ’15.

While the overall headcount is down, it’s important to note that year-over-year we added over 1,000 primary sales associates across consumer, wealth management and global banking.

Turning to the business segments and starting with consumer banking on slide 12. Consumer earned 1.8 billion continuing its trend of solid results and reporting a robust 21% return on allocated capital.

I would note that pre-tax, pre-provision earnings rose 377 million or 10%. Expense and NII improvement were both notable and together enough to more than offset higher provision expense and prior year divestiture gains.

Revenue was relatively flat on a reported basis compared to Q3 ’15, as 4% growth in NII was offset as I said, by the absence of approximately 200 million of divestiture gains in Q3 ’15. As a reminder these gains in Q3 ’15 resulted from divestitures of an ancillary appraisal business, a card portfolio and some financial centers.

Excluding those prior period gains, revenue improved year-over-year and growth in pre-tax, pre-provisioned earnings was even more substantial. Falling 400 basis points, consumer banker’s efficiency ratio of 55% improved meaningfully year-over-year.

Turning to slide 13 and key trends, first on the upper left the stats are a reminder of our strong competitive position. Looking a little closer at revenue drivers compared to Q3 ’15, net interest income continue to improve as we drove deposits higher. Average deposits continued their strong growth up 50 billion or 9% year-over-year, outpacing the industry.

With respect non-interest income, service charges were up modestly, while card income was down. Spending levels and issuance were strong, but revenue growth was muted by customer rewards. We are attracting relatively higher quality card customers that on the one hand have higher spending habits, but on the other hand receive more awards. This has two important benefits to note; first, rewards deepen relationships, helping to grow deposits and make them more sticky for example. Second, in our experience, these customers have lower lost rates and a reduced need to interact with call centers, thereby allowing us to lower costs.

Turning to expenses, they declined 7% from Q3 ’15 despite the higher FDIC assessment charges in the quarter. Expense reductions are the result of a number of initiatives. For example, mobile banking penetration helps to optimize our delivery network, while improving customer satisfaction. More chip cards help us lower fraud cost and digitization of processes and statements helps us eliminate paper and related handling cost.

One can observe the impacts of these types of initiatives on the cost of deposits which continued its March lower dropping below 1.6% this quarter. Focusing on client balances on the left, in addition to deposit growth, Merrill Edge brokers assets at a 138 billion are up 18% versus Q3 ’15 on strong account flows and market valuations.

We also increased the number of Merrill Edge accounts by 11% from Q3 ’15. We now have nearly 1.7 million households that leverage our financial solution advisors and self-directed investing platform.

Moving across the bottom right of the page, note that loans are up 7% from Q3 ’15 on strong mortgage and vehicle lending growth. As we viewed in previous quarters, we continue to focus on originating high FICO score loans, which have generally produced low loss rates and strong risk adjusted returns.

Loan growth included consumer real estate production of 20.4 billion, up 21% from Q3 ’15 and in line with Q2 ’16 as customers continue to take advantage of historically low interest rates. We retained about three quarters of first mortgage production on the balance sheet this quarter. Average vehicle loans were up 17% from Q3 ’15 with average book FICO scores remaining well above 750 and net losses remaining below 30 basis points.

With respect to US consumer card, average balances grew 7% from Q2 on an annualized basis, aided by seasonal backed school lending. We issued more than 1.3 million cards in the quarter and spending on credit cards adjusted for divestitures was up 8% compared to Q3 ’15.

Turning to slide 14 in digital banking trends, as I mentioned earlier, we continue to see strong momentum in digital banking adoption with use across service, appointments and sales. Mobile banking in transforming how our customers bank and reshaping our consumer segment. Importantly as adoption rises, particularly around transaction processing and self-service, we see improved efficiency and customer satisfaction.

We continue to improve capabilities with the latest example being the launch of our Spanish mobile app which attracted over 800,000 active users in the first 10 weeks. We added roughly 1.1 million new mobile users in the quarter. The pace of user growth has increased despite an already impressive penetration rate of our check-in account holders.

With more than 21.3 million active users, deposit from mobile devices now represents 18% of deposit transactions, and 26 million checks were deposited via mobile devices this quarter. That is an average of 280,000 deposits per day, an increase of 27% year-over-year and the equivalent to volume of 830 financial centers. Digital sales now represent 18% of total sales, and we now have more than 3500 digital ambassadors in our financial centers driving further adoption.

Also as you know, we are a leader in person-to-person and person-to-business money movement through digital transfers and bill payment capabilities. Consumers moved 243 billion in Q3 up 6% from last year, and while all this is transformative, I would just remind you that we still have a little less than 1 million per day walking in to our centers across the US. This in-person interaction is important in terms of deepening and retaining personal relationships, providing more complex financial help, and creating opportunities for further engagement.

Turning to slide 15, global wealth and investment management produced earnings of 697 million, up 10% from Q3 ’15. Now it’s no secret that this segment operates in an industry undergoing meaningful change as firms and clients adapt to the new fiduciary rules and other market dynamics.

The good news is, we start from a position of strength with 2.5 trillion in client balances. We have market leading brands and a wide range of investment service offers from self-service to fully managed, plus we have the resources to continue to invest in market leading capabilities that address the changing needs of our clients.

Year-over-year, revenue is down modestly, but expenses were down even more improving pre-tax margin to 25%, up meaningfully from Q3 ’15. Overall revenue declined 2% from Q3 ’15, as NII growth was more than offset by lower transactional revenues. NII benefitted from solid loan and deposit growth, non-interest income declined from Q3 ’15,driven lower transactional revenue that continues to be impacted by market factors as well as migration of activities from brokerage to managed relationships.

Non-interest expense declined nearly 313 million or 6% from Q3 ’15, with half of that benefit derived from the exploration of the amortization of advisor retention award that were put in place at the time of the Merrill Lynch merger. The rest of the improvement was a result of work across many categories of expense, more than offsetting higher FDIC cost.

Moving to slide 16; we continue to see overall solid client engagement, client balances approached 2.5 trillion and are up from Q2 including higher market valuations, 10 billion of long term AUM flows and continued loan and deposit growth.

Average deposits compared against Q3 ’15 are up 4%, driven by growth in the second half of 2015. Compared to Q2, average deposits were impacted by seasonal tax payments. Average loans were up 7% year-over-year, growth remained concentrated in consumer real estate and structured lending.

Lastly, earlier this month, we announced some innovations to our IRA products and services which we believe position us to better serve our clients, given new fiduciary rules. These innovations are industry-leading and address not only the new fiduciary rules for time and accounts, but also client preference for more choice and new ways to invest.

First, we announced the roll-out of a new offering called Merrill Edge guided investing. This solution offers clients online investing, enhanced with professional portfolio management. With the addition of this solution, clients have three fundamental choices which they can mix and match to best meet their needs.

Clients can invest online, completely self-directed through Merrill Edge or if they are interested in enhanced professional portfolio management, they will be able to use Merrill Edge guided investing, or they can chose fully advised working one-on-one with the financial advisor via brokerage or fee based advisory platforms.

We also announced at the beginning in April 2017 for clients that chose to have a financial advisor provide advice with respect to their IRA accounts, we will provide this service through our fee based advisory platform Merrill Lynch One, as we believe this is the best way for us to deliver for IRA clients who chose to have this level of service and advice.

Clients will also have the option to invest their retirement through Merrill Edge either completely self-directive or through Merrill Edge guided investing.

Turning to slide 17, global banking earned 1.6 billion which is up 22% year-over-year. Q3 reflects good revenue growth, solid cost control and solid client activity. The efficiency ratio improved to 45% in Q3.

Compared to previous third quarters, the investment banking fees this quarter were the highest since the merger with Merrill in 2009. Return on allocated capital was 17%, a 300 basis points improvement from Q3 ’15, despite adding a couple of billion dollars of allocated capital this year.

Global banking continues to drive loan growth within its risk and client frameworks producing solid year-over-year improvement at NII. Revenue growth also benefited from roughly a 175 million from gains on [NPL] this quarter versus loses in Q3 ’15. Higher treasury fees also added to revenue growth.

A decrease in non-interest expense compared to Q3 ’15, reflects good expense control that offset modestly higher revenue related compensation and higher FDIC costs.

Looking at the trends on slide 18 and comparing to Q3 last year, average loans on a year-over-year basis grew 26 billion or 8%. Growth was broad based across large corporates as well as middle market borrowers and diversified across most products. Having said that, as we noted last quarter the pace of commercial loan growth has slowed over the past couple of quarters, demand across the industry appears have slowed as well.

We remain diligent in certain sectors such as commercial real estate and energy, and we are also closely monitoring certain international regions. Average deposits increased from Q3 ’15, up 10 billion or 3% from both new and existing clients. As we grow treasury services, we remain focused on quality deposits with respect to LCR.

Switching to global markets on slide 19, let me start by reviewing what I said last quarter, regarding this segment. The past few quarters are examples of the importance of this segment to not only its clients around the world, but also to the customers and clients of all our business segments.

Again this quarter, global markets delivered for clients by helping them raise capital, buying self-securities, as well as manage risk. We continue to invest in and enjoy leadership positions across a broad range of products. We believe this improves the sustainability of our revenue and makes us more relevant to clients across the globe.

We’ve been there for clients when they needed us across all these products. Our results this quarter reflect the strategy and continue commitment to clients. Global markets spent 1.1 billion and returned 12% on allocated capital. Revenue was up appreciably year-over-year and even outpaced typical seasonality by posting modest improvement over Q2 ’16.

Total revenue excluding DVA was up 20% year-over-year on solid sales and trading results, which rose 18%. It’s worth noting we achieved these result with slightly less balance sheet, lower VAR and 7% fewer people. Continued expense discipline drove cost 1% lower year-over-year as increases in revenue related incentives were more than offset by reductions in operating and support costs.

Moving to trends on slide 20 and focusing on the components of our sales and trading performance; sales and trading revenue of 3.7 billion excluding DVA was up 18% from Q3 ’15, driven by FICC.

In terms of revenue, this was the best third quarter in five years. Excluding DVA and versus Q3 ’15, FICC sales and trading of 2.8 billion increased 39% as we built momentum as the quarter progressed across a host of credit products and continued gains in rates products. Mortgages showed particular strength among credit products, as investors sought yield.

Equity sales and trading were solid at $1 billion in revenue, but declined 17% versus Q3 ’15, which benefitted from higher levels of market volatility and client activity. On slide 21 we present all other, which recorded a net loss of 180 million. This loss includes a previously disclosed tax charge of 350 million due to the third quarter UK enactment of tax rate reduction, which reduced the value of our UK DTI.

A loss in the current period compares to earnings of a 152 million in Q3 ’15 as lower security gains and higher expense litigation offset higher mortgage banking revenue. MBI revenue this quarter includes 280 million benefits from higher valuations on our MSR driven by slower expected prepaid speeds based upon recent observed trends and customer behavior.

Let me offer a few takeaways as I finish. We reported solid results this quarter that were consistent with our strategy responsible growth. We remain focused on delivering responsible growth as well as strengthening and simplifying Bank of America.

Capital and liquidity strengthened, asset quality remained strong. We grew revenue, we grew deposits, we grew loans, we delivered for clients in capital markets, we lowered costs. We invested in our future by adding sales professionals and deploying technology that helps the customers better live their financial lives and improves satisfaction. And importantly, we returned more capital to our shareholders.

With that lets open up to questions.

Question-and-Answer Session

Operator

[Operator Instructions] we'll take our first question from John McDonald with Bernstein. Please go ahead. Your line is open.

John McDonald

Just wanted to ask about expenses, could you talk about what kind of timing expectations you have under various projects helping to drive down your expenses further in 2017 and '18, maybe just remind us what are some of the big items that you're working on and should we still think about 53 billion in 2018 as kind of your hard target that you're shooting for.

Paul Donofrio

Well let me start with the last part first, nothing has changed at all for our thoughts regarding the 2018 target that we discussed in the second quarter call. Again, I would note that, year-over-year we've reduced expenses by $0.5 billion. And I would also just point out to remind everybody that if you look at expenses over a longer term, we reduced quarterly expenses ex litigation by 4.8 billion from Q3 '11, that's a 19 billion run rate.

So if you think about what we have to do between and 2018, I think we talked about this before, roughly a third of that is going to come from continued progress on delinquent loan servicing. The other two-thirds is going to come from a lot of different initiatives across the company. We've talked about same or simplify an improved initiative. We're going to be utilizing technology to digitize processes, eliminating handling cost. We're going to get technology efficiencies from our datacenters consolidation and from more efficient servers.

As I said, we're going to continue to make progress on delinquent loan servicing cost, hopefully see some modest improvement on litigation. A very important part of this is the shift to self-served digital channels, mobile, online, ATM. So that's what the list sounds like and it goes on and on.

I would emphasizes this shift to self-serve. We're seeing good momentum with more than 21 million mobile banking active users and that's growing every week, every month. 18% of our deposit transactions are now completed through mobile devices, that's better for customers, it's also better for our shareholders. It's one-tenth the cost of walking into a branch. So it's all these things kind of put together, it's initiatives across the whole company. It's going to come a lot from support and operations, but there's a little bit in the front office as well as we get more efficient.

John McDonald

In terms of the timing Paul, is it something that we should think of as ramping throughout 2017, and is it longer tail at the end. Can you give us a sense there?

Paul Donofrio

I would say it's going to be fairly spread out throughout the whole process, however, as you think about one quarter over next, it's not going to be straight down every quarter. Not every quarter is the same, there is going to be some lumpiness. Let's look at the fourth quarter for example, we traditionally have some seasonality in the fourth quarter, so generally we'll make progress, but don't expect that you're going to see it in every single quarter.

John McDonald

And then a second question just quickly on net interest income. Can you help us try to translate your 100 basis points rate sensitivity into something closer to what one fed hike might do for your net interest income, and what would be the trajectory of NII and NIM if we did get a fed hike this quarter? What would you expect more in the near term next quarter too on NII and NIM?

Paul Donofrio

I can help you through that. So if you look about 25 basis points that would be one quarter of our 5.3 billion in sensitivity. If you want to assume that 25 basis points increases the long end by 25 basis points, you kind of know the answer. You can roughly take a quarter of it, perhaps even a little bit more because we're probably more asset sensitive on the first 25 and the last 25 of that 100.

But if you don't want to increase on the long end, just look at the short end we've disclosed. It's 3.3 billion, you could divide that by 4 and get a pretty good sense of what 25 basis points would do over the subsequent 12 months.

Operator

And we'll take next question from Glenn Schorr with Evercore ISI. Please go ahead.

Glenn Schorr

Just curious for point of clarification, Brian had mentioned global markets, feels like it's taken a little share. Alluded to global peers restructuring, completely get it, believe it’s going to happen. Just curious if you can give a little color on where you might see some of that evidence taking shape product, [indiscernible] whatever?

Paul Donofrio

I’ll try to do that, but let me just start with a couple of thoughts. First of all, I think it’s difficult to see share shifts in global markets in any given quarter. Fee pools are just not as transparent as they are, and let’s say invest banking fees or other areas. What we know is client activity was up in the third quarter and that’s what drives our short term results.

Over the longer term, it’s easier just to assess what’s going on with fee pools and share. So, I just want to point out from ’14 to ’15 on declining fee pools, we’re pretty sure we improved our share, third parties tell us that. And I think that share has come from a number of regions and a number of firms and a number of products as competitors adjust their strategies and capabilities.

More specifically we’ve been investing in rates, but for a number of years, I think we’re making some progress there. We have a very strong credit platform as you know, I think we’re making progress there relative to the competitors around the world, and I think we’re investing in equities, and I think your equities revenue is down, but I think you’re seeing improvement relative to the fee pool and equities as well.

I do want to emphasize very importantly that our strategy is to have a diversified product portfolio across both FICC and equities and globally. That’s what our clients need and want from us, and so you could see gains one quarter and one place and see something lower in another place, and that’s okay with us. That’s our strategy. It’s about what the client needs in any given quarter. If we’re doing a little bit worse in one place, we’re probably doing better in another place.

Glenn Schorr

Fair enough nature of the business, I guess. One another one, and I appreciate all the color on the different products and what you’re doing on the wealth management. The curious move in the quarter was the move away from the commission based IRAs, and I’m curious, is that more specifically done to avoid the best interest contract. I’m just curious based on how we roll forward, if the SEC comes in, what that might mean. You talked about giving customer choice, but this sounds like less choice for the FA.

Paul Donofrio

Look, clients are going to have three ways to invest in their IRA, they're going to do it completely, self-direct to Merrill Edge. They are going to be able to do it online, but enhance with professional portfolio managed through Merrill Edge guide and investing. And again for those clients who want one on one advice and service from their FA, they're going to be able to do that on a fee based advisory platform.

What we've decided not to do is use the best interest exemption to allow IRA accounts to be added to our brokerage platform where clients pay on a transaction basis. After reviewing all our options, let's say, if a client choses one on one advice and service on her IRA, we believe the best way to provide that advice is through Merrill Lynch One on our fee based advisory platform.

We took a lot of time to make this decision. We took months thinking about this, we did research. We believe this is in the best interest of our client and our advisors.

Glenn Schorr

I don't doubt that, I worry about just the execution of it. I'm assuming it means that the advisor has to talk to the client and explain this whole thing and just --.

Paul Donofrio

Yeah, that's right. But the advisors are going to be tough to their clients and explain the best interest exemption. That's going to be a much harder compensation than the one we're going to have.

Operator

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

Betsy Graseck

Couple questions, just one on loan growth, could you give us a sense as to how you think you're trajecting there. We talked a little bit about market share and trading. Could we talk a little bit about how you think you're doing in the lending side of the equation and if there's any like there.

Brian Moynihan

We feel good about loan growth, the economy feels good. So we are confident that we can grow. But of course there's going to be some uncertainty, and as I said in certain sectors and certain regions around the world. I would remind you that we are focused on responsible growth. So, in some of those, we're going to look a little bit different than some of our competitors in some places, but we feel good. Year-over-year if you look at our business segments, we had 7% loan growth.

Betsy Graseck

One of the areas that I just wanted to dig in a little bit more to is on the mortgage side where you have had some loan growth, but I'm just wondering if there is more opportunity there as it relates to either taking some duration exposures or on credit as you've moved in to some wider credit boxes with my first home which is insure by Fannie and Freddie, but just want to get some color on that.

Brian Moynihan

Betsy if you go to page six of the materials you can see that we're continuing in the mortgage area overall, so thinks both in home equity and first mortgage loan. You can see that we continue to run off some of that non-core portfolio and overall the balances grow in the business segment, and we expect that to continue. We're doing about 2,000 applications a day, we've got a 1,000 each plus in each of the products that have continued to grow. And so we'll continue to drive that core capability to the customer.

In terms of expansion of product sets, we have a limited product that we built for some of the 3% down payment for $0.5 billion a year for production just to give us a more competitive product there but limited to size, and we'll do some other things. But we're going to stick with the core credit.

Remember who you're talking to her Betsy. In our experience the mortgage is probably deeper than most people. So we will stick with what our customers need and what we think the right but for the company is.

Betsy Graseck

Okay, so as you're thinking about your revenue growth from here, which are the three key legs that you expect are going to keep that revenue growth growing.

Brian Moynihan

I think if you think about the growth, you've got the side and you've got the fee side and if you think about the interest side it's going to be driven by balanced growth between loans and deposits, and I think we keep growing deposits every year $60 billion we're paying four basis points in consumer and think about that dynamic and putting that to work in anything we can is important, and we continue to grow loans at less rate than we grow (inaudible). If that's going to drive our NIM, it's just a bigger and bigger, lower and lower cost deposit base.

And on the loan side, I think consumers growing better now than commercial in linked quarter, but overall we expect commercial will get back in a little bit as the economy continues and some of the uncertainty listed in the political season here.

So on loans and deposits, it will just be growing out. As you've seen year-over-year, our core growth is 7% on loans and growth on deposits. On the fee side, what you're seeing is the dynamic and its specially fee areas finally turn a little bit stable and then turning for us in the card revenue and things like that, which would hit sort of the inflexion point where the run down and relative interchange due to selling some portfolios and getting out of non-core portfolios and putting on the core portfolios with rewards attached to which helps us generate deposit and things like that is stabilizing and starting to see in the last few quarters, card income starting to move up a bit. And on services charges it's been relatively stable.

So the fee side will be driven more by wealth management and markets and things like that and consumers' stable which is good because it had been a drag for a long time.

Betsy Graseck

And then on the expense side, you indicate all of the various technology efforts that you've got underway, but is there more that you can do on the comp side as well?

Brian Moynihan

When we have less people going through our bonus pools and stuff, so you can see the comp continue to drift down. A large part of the comp obviously is the wealth management business which there's no meaningful changes there, but in the other businesses we continue as we have less people, we continue to reduce that as a percentage of revenue.

Operator

We'll take our next question from Jim Mitchell with Buckingham Research. Please go ahead.

Jim Mitchell

Maybe you could talk a little bit about the credit cycle, I think one of the major pushback from investors is that we're going to start to see credit at worse. But I think you guys are pretty clear that you are not lowering standards to drive growth. So how do you think about the cycle from here, like I said at the start?

Brian Moynihan

I think I said it earlier, if you think about the last several quarters of earnings call, it's not going to get any better than this and every quarter it gets slightly better and that in part is because we're still getting the benefits of the changes made six, seven, eight years ago coming through the consumer business i.e. that what we call back book portfolios or legacy portfolios or whatever word you want to use continue to run-off with higher credit risk and we keep putting and have put on and continue to put on higher credit quality.

So if you think about overall charge-offs of 880 this quarter, that's driven by the consumer business and that's driven by the card and some in legacy home equities. And so keeping the card business where we wanted is critical and you're seeing us continue, even as we start to see that portfolio both nominally and rate the charge-off picture strong.

So when you go back and look at what happened during the crisis the charge-offs came abnormally from the edges of credit and we've kept ourselves out of that.

Jim Mitchell

So you feel like you can keep at least ratios as you grow pretty stable?

Brian Moynihan

We have done that.

Jim Mitchell

And just maybe follow-up on the capital ratios, while also that the [RTB] ways drops while the balance sheet grew a little bit. So it seems like you reduced risk. Where was that and can that continue?

Paul Donofrio

Yeah, now you're speaking about the advanced approaches we had dropped. We have it under standardized as well just late last. And that drop came again from legacy portfolios running off, and from a continued work by our goal markets team to better manage their balance sheet relevant to those ratios.

Jim Mitchell

Is there any more detail or can you get a little more from here?

Paul Donofrio

Yeah, there's always more to do, and we are focused on a lot of different regulatory metrics, and we're looking at all of them where there are some maybe a little bit more important than others right now and we are focused on all of them. And I think there's more to come there.

Obviously as we grow balance sheet, as we grow loans and deposits, we are going to continue to see some increase particularly on the standardize side. But relative to that growth we can continue to make a little bit of progress incrementally.

Operator

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

Matt O'Connor

Can you talk about the strategy within the securities book? You did mention that you added some later in the quarter, and obviously deposit growth has been exceeding loan growth to justify that. But give some color in terms of what you are buying, the duration, and how to make sure it doesn't get too big relative to the size of the balance sheet.

Paul Donofrio

Yeah Matt you pick up on the (inaudible) and the drives. We have a securities portfolio because we have more deposits coming in that we have loans. So our view of that portfolio is, we don't take credit risk there and so we have two alternatives treasuries and mortgage backed securities or cash I guess is the third. And so that's how we invested and Paul can take you through his earlier comments a little bit and give you some color on that.

But I think people always have to remember, the reason why we have more is because our deposits grew at $60 billion year-over-year and that's more than our loans grew by quite a bit. So Paul you want to answer or give some color on that.

Paul Donofrio

Sure. Just one step back, obviously what we're doing every day is managing earnings, capital, liquidity and interest rate risk. We think that portfolio and where we want to invest things. This quarter as you noted, our deposit growth exceeded our loan growth, and so we did add significantly to the investment portfolio.

Most of that incremental amount we devoted to treasuries, just as we think about the balance in that portfolio, we wanted just to add a little bit more treasuries. That's really kind of it.

Matt O'Connor

And then a little bit related, but on the deposit side, obviously a very strong growth year-over-year, you mentioned $60 billion and really little to no repricing despite the one bump in fed rates that should impact the year-over-year comp. So, I guess the question is, if we do get a rate increase, do you think you've got more flexibility to limit the possible pricing given its basically worked so far and loan growth has obviously not enough to absorb the deposit growth you have.

Brian Moynihan

Remember that the reason why you don't see much repricing is really two or three dynamics. One is, a 450 billion of our deposits are non-interest bearing. So they aren't going to reprice. The great debate is about how sticky are those. And if you think about that, and there's a dominate by our consumer business and our non-interest bearing accounts and consumer have doubled in size over the last five or six years due to focusing on primary accounts in the house or where they run their household finances through our account and therefore the correct deposit are check and things like that.

So, the first thing the number are [1 trillion] to 450 non-interest bearing and a dominant part of that consumer and also in the wealth management, (inaudible) transactional count of both consumers and then on the business side similarly we have driven our deposits to be really LCR friendly and core operating accounts. And so those aren't going to move, the non-interest bearing aren't going to move much and the big debate is how much balance will be there and we feel confident that the balances will stay just because of the nature of the accounts.

And then when you go to the second dynamic, remember with all those deposit growth, one of the things we continue to do and the impact less and less is we are expecting consumer business running off CD still at a fairly decent cliff that were historically used to fund prior companies, balance sheets that we don't need the funding that caused.

So we have some roll over, but that continues to decline, that weighted average cost drops off and that cost drops off and it drives down or holds steady the weighted average cost. And then if you look at money and other interest bearing they really haven't moved much. So we feel good about the consumer, we forget base overall. We feel very good about the consumer deposit base just cross 600 billion for the first time in the company's history and consumers generally, and with that I think if rates rise, we think that it is substantial value for the company and Paul gave you what you think about that earlier with a quarter of 3.3 billion, 25% of 3.3 billion.

Operator

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

Ken Usdin

Wanted to ask about the card business a little bit, I saw in the deck that you grew card issuance at the fastest level since 2008. And there is a burden on the fee side with reward stuff and balances are still flat. I was wondering if you could walk us forward and help us understand a little bit better just the ROA and income direction of the card business? When do we start to see that show up in both balances, and when do expect to see that fee growth come along for the ride, given the good underlying growth that we haven't quite seen yet in the financials?

Paul Donofrio

I think you're noticing some modest card balance growth in the quarter, which we think will continue as we add new accounts and again we're very focused on adding high quality accounts there. I think you probably also noticed that while combined debit and credit card spend was good in the quarter at 5%, 6% of it could fuel, I'm adjusting for our divestitures last year that the growth in the card camp was impacted by customer reward programs.

However just focusing on the fee income, this is some really key benefits of our strategy which is a track relatively higher quality card customers reward them for deepening their overall relationship with us. This strategy really drives deposit growth and makes deposits stickier, plus we believe these customers have little loss rates, they used to (inaudible) which helps us lower cost.

I think when you want to see the effect of this, you have to look at the overall consumer segment and what's going on there in terms of growth of profits and improvement in expenses. And lastly I just point out, our risk adjusted margins on card are stronger and over 9%. This is in no way a signal that we are not going to be able to grow the card income line. I just want to get a better sense of how we think about it.

Brian Moynihan

I think if you think about that more broadly, we had the last divestitures of size we made in this card business were the fourth quarter of last year, and now through the P&L. So you were through the balances and through the things. And what you're starting to see if you look at the trends this year, you're starting to see positive movement both in card income and in balances as we move across the year and we expect that to continue.

It will be strong responsible growth and one of the great debates we have in the company as people say why can't you grow this faster or we're giving up too much in the interchange for the preferred balance the preferred rewards. The interesting question is, are you giving up something you'd never have in the preferred rewards i.e. we're bringing more customer relationship in debt and that gets us something.

So incrementally the net interchange is actually there as oppose to what theoretically get gross interchange with a non-customer in the (inaudible) program. So, we focus on entire customer relationship. It is very valuable, it is very powerful. And believe me if we could grow faster responsibly we would. But the idea is just to grind up a slow and steady growth and we're starting to see that come through and largely it was massed in '14-'15 and behind that those areas, because we are divesting a lot non-core relationships and now we have synergy one and we have the core card business we wanted.

Paul Donofrio

And again you can see it if you look at the whole segment. I'm also comparing us to peers, but just take a look at our PP&R year-over-year it fell 10%.

Ken Usdin

Understood. Second quick question is you mentioned that you are now achieving the cost of capital in an ROE above 10% and capital is just still building. Do you think you can continue to hold does not improve the ROE as capital will likely continue to grow, presuming that you still will get those benefits going forward, and you are not at the point of returning more than 100% of your earnings yet?

Brian Moynihan

Well I think embedded in that the future return of capital and we now have a significant buffer above the requirements. And as Paul said, we continue to optimize our requirement. So I think you're little bit of a horse race between increasing earnings and increasing capital and as we return more you expect that the horse race increasing earnings would stay ahead of it. But we've got room to go and we're driving at it. But if we don't hit - the issue is that our capital continues to grow that capital is also used as investor and continues to go under our book value and so it's not going anywhere. It's there to be returned when we can get through the process of getting from where we are to higher percentages of capital return and ultimately returning excess capital.

Paul Donofrio

And we have a goal to return more.

Operator

And we'll take our next question from Mike Mayo with CLSA. Please go ahead.

Mike Mayo

You've reduced your branch count from 6,000 to 4,600, where do you think that count can go? And on the one hand, we heard you say almost 1 million customers walk into branches each day, but on the other hand you have grown deposits 1.2 trillion. You did mention more self-service digital channels. You did mention mobile banking is 18% of the deposit transactions, and less reliance on the branches might ease any extra pressure to sell more products in this low rate environment. So where do you think you might take the branch count to, and I don't think you mentioned the impact of the cross-selling issues on Bank of America or if we wake up one day and find out that Bank of America did something inappropriate?

Brian Moynihan

Well lets go to how we run our consumer business. We run our consumer business consistent with responsible growth for the company, and what that means is that you focus on deepening relationships what we call [stair stapler]. It's the core deposit account, the core credit card and getting it used in the core mortgage and the core home equity and the core auto loans that's what we've been driving at and we continue to drive that and that's the backbone of what we did and how we reposition this company over many years.

In terms of the branches, Mike, yeah you rounded off our statistics which Paul talked about earlier, but it is a complex optimization in it but it all starts with the consumer. What is the consumer going to do? And so while 18% of deposits were made by mobile, the deposits 82% by the very nature aren't. And where do they go? About 50 percentage points of that go through the ATM and about another 30% odd go through the teller line still today. And so you have to be ready and able to serve in all dynamics.

So what we continue to do is optimize the branch structure, the call structure, the ATM structure, the mobile structure and the online structure altogether. And the way to think about that optimization and why it is extremely important business to the company is that we've gone from 300 basis points the cost of all that to deposits to about 150 over the last 6-7 years and that's by continuing to optimize the physical plan as well as all these other means. So if you ask me, your question is, how far you can you? You have to also then think about what we want to do monitor branch.

So if you look back at some of the statistics that Paul had in the deck for consumer, when you see things like appointment set up or 340,000 in the third quarter. So just think about, 340,000 times the customer went on a mobile phone and asked to come to a branch. So we need those branches to receive those mobile phone customers and why are they coming usually for much more important financial transaction to them then handing us a check for deposit.

So it's a quality versus quantity and making sure we understand. So we are optimizing all those and you can see them on page 14 on the lower right, you can see different clues. I'd say we went from 7 million visits probably 4-5 years ago to 6 to 5. But those 5 are of a higher quality, and we think that's important. And there are certain transactions and certain capabilities that you just have to have at your branch, and you just have to do it face to face, Very difficult things like, how to get a power of attorney for a parent that's sick or I want to do a mortgage, still difficult to do through the phone and things like that.

So we'll have all aspects, we drive it down and then you can see that we continue to make that progress..

Mike Mayo

I mean just as a follow-up and slide 14 is kind of saying Bank of America we're a [Thinktech] company and look how well we are doing, and you are showing some good growth rates. That chart on the upper right, so at what point does that lead to a greater number of branch reductions? Do you have the answer and you don't want to say for competitive or you don't know yet, it’s kind of a give and take based on the customer experience. Some of your competitors talk about closing 100-200 branches per year, you reduced 112 over the last year, but it seems to be slowing. So I’m trying to get a sense of that.

Brian Moynihan

I’d say that the point is that, we’ve run this business and we start with the consumer and their activities and their behaviors. So what they want to do and the key is not to get ahead of them, because that can cause you problems and not to be behind them because that can be cost issues and empty branches. So even in the 112 we’re down we’ve added branches in places like Denver. The Denver branch that we’re adding are top 10% of performing branches today on relationship building. We’ve added branches in Manhattan, we’ve added branches in Minneapolis. And so we’re in a sea change in terms of what the branches look like individually. The new branches are different.

We’re adding branches we didn’t have, we’re closing branches where the utilization isn’t there. The nature of how far a customer will travel is also different now than it was 10-15 years ago. I think you said what are all the different reasons? The answer is, I think you said we’ll follow the customers and I don’t know the exact number because I can tell you, eight years ago when we had 6100, there were people who said there was never going to be less branches in our system and maybe we should add more and guess what we’re 4500.

Operator

We’ll take our next question from Paul Miller with FBR & Company.

Paul Miller

You guys took an MSR write-up or a hedging benefit; I can't really which one it is, about $360 million. But you did write up the MSR from 51 basis points to 60 basis points. Was that all rate driven, the 10 year did go up a little bit or was that also some better credit metrics out of the servicing portfolio?

Paul Donofrio

We had a $280 million benefit this quarter and that was from a higher valuation of the MSR, which was due to slower observe pre-payment speeds. So we’re just updating the way we value that. We have to monitor our - it’s a level three asset, so there’s a lot of things that go in to that. It’s hard to value and you’ve got to be continually looking at that valuation and we thought it was time based upon observation of pre-payment speeds to make a change in some key assumptions.

Operator

We'll take our next question from Eric Wasserstrom with Guggenheim Securities.

Eric Wasserstrom

I just wanted to follow up on a couple of questions related to the various consumer lending businesses. First, Paul just from your response to Ken's question a moment ago on card. I heard everything you said about the risk-adjusted margin and the credit quality of the portfolio, etcetera. But just to be clear, are you expecting improving, stable or deteriorating ROA based on the current competitive environment, because it seems like many peers are underscoring the near-term risks to profitability from awards and customer acquisition costs?

Paul Donofrio

Look based upon how we're growing the business, how we're running the business we expect stability.

Eric Wasserstrom

And with respect to mortgage, I saw there was about $100 million benefit from rep and warrant release. How much of that reserve still exists and what would be your expectations about potentially realizing it at this stage given where we are with respect to that issue?

Paul Donofrio

The rep and warranty is counter revenue. So was that you were referring to?

Eric Wasserstrom

Yes, correct. It's the provision line item. You had a negative provision.

Paul Donofrio

So if that's going to bump around, that bumps around because --.

Lee McEntire

Eric, it's Lee. I think what you're looking at what Paul is referring to is a contra revenue item, so it's a negative revenue item when its provision expense on the provision.

Eric Wasserstrom

Maybe I will come back to you in a bit. Just finally on auto it seemed that some peers were signaling that competitive conditions in auto underwriting were easing a bit after intensifying over the past several quarters. Are you seeing anything like that across any particular segment of the FICO strata?

Paul Donofrio

We're continuing to see good growth in consumer vehicle lending the way that we run the business. We're up roughly 7% or $7 billion or 17% year-over-year. Again we're focused on prime and super prime, so originations were down modestly Q3 versus the prior quarter as we accepted a little bit less dealer flow, but we still feel good about that product offering.

The third quarter average book FICO scores remained at approximately 770, debt-to-income was at all-time lows. We're not following the market expansion to 84 months in terms of tenure. We've got a maximum tenure of 75 and I think in the third quarter we were averaging around 67. So we're getting the growth within our responsible growth framework and we feel good about it.

Operator

We'll take our next question from Steven Chubak with Nomura. Please go ahead.

Steven Chubak

Want to kick things off with a follow-up to an earlier question on the DOL. Paul you had noted that Merrill FAs will no longer be permitted to engage in brokerage activities in retirement accounts. I was hoping you can give us an update as to what portion of Merrill client assets are currently in brokerage IRA, and maybe more specifically, how should we think about the net economic impact from transitioning some of those retirement assets into some of the other offerings that you highlighted, whether it be fee-based which should generate higher fees versus robo or self-directed Merrill Edge?

Paul Donofrio

Sure. So the primary affected portion of our business is in the transaction brokerage retirement accounts. And if you look at our roughly 2 trillion of due inclined assets outside of loans and deposits, we would see the DOL rule having an impact on significantly less 10% of those balances. And again that's as the industry works towards the full implementation of the rule in January 18.

So as you noted, we're going to see some geography movement on the P&L. There's going to be some shifts, and if I had a guess today, we might see some modest revenue impact in 2017, but it's really kind of way too early to know how it's all going to shake out. But we would expect to mitigate that in subsequent years.

Brian Moynihan

I think people, just Steven you talk about backing up for the fuller trends on wealth manager. There's been a constant decline in brokerage revenue over the years largely because it's really been in the industry and we have been moving more to a financial device to manage those account executions. And so in that broker - obviously a limited portion of that's IRA related in both counts, but the reality is this is against the backdrop that you'll see that brokerage number has been tough to chase for five years now.

Steven Chubak

Got it, okay. And just one other quick follow-up on the same topic, the press article highlighted some of the changes that you've made indicated that some clients that would transition to the, "higher touch advisory offerings" will be rebated some incremental fees. I was wondering how are you planning to apply changes to the fee structure for those brokerage assets that do, in fact, transition. I'm just struggling to see how a two-tiered structure might work in practice across the hundreds of billions of assets that would be affected here?

Brian Moynihan

I think the implementation has to be carefully handled. In the team Andy and John have been leaders in trying to figure this out the right way for the client and we start with what's best for the client. So what you're reading about is, there'll be adjustments made clients-by-clients basis in that circumstances and what they want from us, and FA's will engage in a lot of conversations about that as we go through the next several months.

Steven Chubak

Okay, thanks Brian. Just one more on the topic of capital, just switching gears for a moment. Following (inaudible) recent remarks, there's one area of debate has been whether the Collins Floor would in fact apply to this new capital framework, i.e. whether you will be forced to manage to capital minimums under both the standardized and advanced approaches. Now that you've had some time to digest the initial release or guidance, I was wondering if you can give us any insights into how you are thinking about that potential change?

Brian Moynihan

Okay well that looked like obviously a technical question and it's not that we haven't thought about it, but to be frank, its' just a speech at this point and he didn't really address that in his speech. So we don't really know the answer. That's one of the questions we have. I think once we get the best proposal we'll have a better idea, but all I can tell you is based upon our current reading of the speech, and particularly some of the changes you mentioned in CCAR around asset growth, we think that the substitution of the capital conservation buffer would be with the stress capital buffer would not be a material change for Bank of America given our risk profile and given how we run the company.

Operator

We'll take our next question from Brian Foran with Autonomous Research.

Brian Foran

I guess we've had a couple of good quarters in FICC both for you and the industry, and I know volatile business not really looking for quarterly expectations. But just more broadly there is an investor debate, is it just a couple of good quarters or has the business absorbed all the changes in regulation, absorbed low rates, absorbed all the restructuring required and the cycles inflecting FICCs at the bottom and has upward pressure from here? So where do you come in on the debate, is it a couple of good quarters at this point or has FICC bottomed?

Brian Moynihan

Well I think the way I come out of that debate is to go back many years ago and sort of think through the repositioning was done in our company and so the key was to make fixed work. You're talking about revenue, but we look at profit and so to get the profit we needed to have a fixed income and equities business. We had to take the cost structure down which we did in '10 or '11. Tom Montage and the team worked very hard at that and got the breakeven down over a $1 billion a quarter. And then we range along those a number of years and they've actually taken out year-over-year. You can see the cost continue to be managed well despite higher revenue.

So I would say taking discussion I would say that the way our fixed income business generates revenue, a lot of it is around our capabilities and underwriting, our competitive capabilities and all the different from high grade leverage to everything that goes on and that's a relatively stable pool of revenue that you see repeated. And what goes up or down is really the activity around that based on the market ceasing in certain quarters in terms of the issuance and things like that.

When you think about the other thing that Tom and the team had to really go after which is to broaden our capabilities in the macro segment a little because that was something that traditionally the Bank of America/ Merrill Lynch came together and so that's added some more volume to it. So we think we've been gaining share as Paul said earlier.

When you look at revenue comparison with one of the top 10 without all the [lead] charge or just revenue, but we think its driven by our fixed income capability and its driven by our connectivity from the issuer of the bonds and debt to the investor, and we'll continue to drive that. So the teams' done a good job and I'd say we're at a fundamental level.

Well this quarter feels better than last year's quarter. It's not a quarter that when you look across four or five years that we haven't come close to on many cases and have done better than a few times.

Brian Foran

I guess a similar question on commercial lending. You referenced some of the strategies you have in place driving responsible growth, and how you felt good about the business going forward. But we saw this pause across the industry in the third quarter in commercial growth, the Fed numbers, your numbers, other banks reporting so far.

Have you seen signs of customer demands coming back late in 3Q and early in 4Q, do you have visibility and confidence that the commercial loan growth cycle more broadly is still in gear?

Paul Donofrio

What we noticed in commercial in the quarter was lower industry growth this quarter, and I think that really reflected a slow-down in closed, actually books closed acquisition financing for us which probably may be different for peers depending on the timing of transactions. And then uncertainty around the election and then I think some lingering concerns around certain countries or regions. That's what I think impacted the third quarter.

When you look at the US, when you look around the globe, when you look at GDP growth, we're optimistic. We think the economy feels good, so in a good economy, we should be able to grow commercial loans. We'll have to stay focused on some sectors and some regions, but we think we can grow commercial loans.

There’s enough utilization rates and revolvers, they came off their highs, but they’re at the higher end of the range which also suggest or reflects good commercial activity. We’re adding bankers in the US and commercial banking in small business. We’re adding them to regions where we know we have some synergies or some capabilities and big MSAs. So there’s no reason why we can’t grow within our responsible growth framework, assuming the economy continues to trough along here.

Brian Moynihan

Also if you think about by sub-asset class in real estate we modulate our growth based on our view of wanting a diverse portfolio and then how we lend in the business. And if you see that number it was growing on and it flattened out a little bit, and that relative to others that was a difference.

But Paul’s last point is a key point. They are a credit worthy customers that we can do more with and the only way to do that is because we have a talented world class commercial banking team, is to add more capacity. And that capacity is starting to build and it takes a while, because we hire commercial banker and we sometimes give them some of the under-covered in our portfolio and then they go after the prospects that we have and it takes a while to build those up.

People don’t change commercial banking relationships in an afternoon. So in our business banking and our middle market especially across America, we have been adding commercial bankers and we expect that to be down to our benefit. Given an environment which maybe solid but okay, we’d expect to gain in those markets as those bankers come on stream and become more productive and Alistair Borthwick and Katy Gnapp and their team is driving that.

It has proven that those bankers do get share and you’ll see that come through.

Operator

We’ll take our next question from Nancy Bush with NAB Research. Please go ahead.

Nancy Bush

We are all of course very attuned to the issue of fraud after the recent news at Wells Fargo, both on the customer side and on the employee side. I guess my question to you would be, as you move more to digital methods of attracting customers and keeping customers, etcetera. Is fraud on either side becoming a bigger issue, or if you could just speak to the whole issue of how you prevent fraud as you become a more electronic bank.

Brian Moynihan

I think when you think about fraud most people think about in terms of the electronic side, most people think about credit card, (inaudible) fraud been tried as a broad word. Arguments about whether the charge was valid, whether a [merchant] and things like that. And so there's long history of adjudicating that.

So as more and more sales online by the consumer, the techniques for online continue to develop. At phase to phase or point-of-sale the chip card win were largely through all our customer having chip cards, merchant what we call chip-on-chip i.e. used with a merchant chip machine is rising sort of 1% or so a quarter and is now as best we judge it in the high 20s or something like that Nancy. So all that being said, we expect to get leverage in our fraud losses in the consumer business, year-over-year we expect that to continue to come down, and so yes, that is a major initiative for us to continue to drive that down, part of its education to consumers, part of it getting the chip cards in the hand getting machine merchant using the chip machines. Part of it is the tokenization and wallets and things that go on in Visa check out and all the variations in Master Card and getting, because that's tokenized better execution and is more secure.

And so our view as a provider has been to adapt all these wallets and technologies that have this tokenization capabilities and that then drives down the cost of losses due to merchant complains and other types of things. So you're absolutely right, cyber security, theft of cards from other people and sold on the internet, all of that stuff is important for us and so we spend as we said $0.5 billion a year protecting ourselves, but also part of it is making sure we understand where our consumers are in terms of lost cards and things like that.

Nancy Bush

Well how about on the other side there, the employee side, opening false accounts. If you could just speak to how you think your methodology is different from what produced the problems at Wells Fargo.

Paul Donofrio

May be I'll take that one. Look I want to take just one step back, because to really answer that question you just have to have a better appreciation for how we run Bank of America, and it truly really does start with our purpose which is to help customers better live their financial lives and from there you have to understand what we mean responsible growth.

If you ask anyone in the company, responsible growth, it's about developing relationships so that we can grow with our customer's overtime, based upon their needs and goals. It's not about the number of products that would be open, its whether customers want to meet the products and services we're offering them and use them. That's how we measure ourselves.

We spent years building controls and governance and escalation around us. We're always monitoring them. It's just how we run the company. So that's probably the best answer in can give you in terms of how we think about this issue.

Nancy Bush

And Brian, I have what is going to be a difficult question for you. But in response to the problems at Wells Fargo, we have seen them separate the Chairman and the CEO roles. And while that may have been due to exigent circumstances, do you foresee another push now either by regulators or by shareholders to separate those roles?

Brian Moynihan

Nancy, I'd say this, if we have dialog with all our shareholders off and Jack Bovender, Lead Independent Director, obviously we went through his, your so-goal, and we (inaudible) they voted on it, but the key is how we run the company, how we govern ourselves. So again Paul's view of what we talked about responsible growth, one of the tents is to be sustainable and sustainable and although it has to be sustainable and it involves things like you got to invest in the future, but also involves how we govern company and our Board, independence of our Board, the experience on our Board, how they approach their responsibilities I think is very strong and our shareholders have understood that agree with that.

So I think we govern ourselves in a very touch fashion i.e. the Board demanding on us and understand the strategy and has helped support through some times when people would challenge it. And I think it's proven to be the right strategy at this point. And so if we to technicalities, our leader and director duty are strong as anybody in the industry. If you look at all the new government surveys have come out all the words about proper governance and all the difference things you've been seeing recently, we made or exceed everything. Anybody says to go to (inaudible) comfortable there.

Operator

We'll take our next question from Brenna Hawken with UBS. Please go ahead.

Brennan Hawken

Just wanted to follow-up on the fiduciary rule questions before. So I appreciate retirement assets are less than 10% of your balances as you've highlighted before. But I think what a lot of folks are thinking about here is that SEC has been pretty clear that they are working on their own version of this applying to taxable. And so when people watch what you are doing here on the fiduciary rule for retirement people, it's sort logic to assume you would apply the same policy in the event we see a similar rule come out more broadly. So isn't that the message that you are basically sending to Fas, and aren't you concerned that FAs might look at your platform versus some of your competitors that will offer the (inaudible) and think that they might have greater amount of flexibility as some of those other platforms?

Paul Donofrio

When you look at the advisor attrition today, its' at an all-time and we don't expect significant attrition for the same reason that attrition is low today. Merrill Lynch is a great place to work and serve your clients. So if you are FA, you're looking at a platform. We have market leading capabilities, we have breadth of products across banking and wealth management.

We have lots of options in terms of servicing clients. We got great technology that we are investing in, tremendous transparency that provider tool, Merrill Lynch One, award winning research and an incredible global execution to global markets. So there's a lot of reasons to be here. This is a great place to serve your clients. We are implementing a strategy that creates significant flexibility for our advisors and we're delivering fiduciary, best interest advice to the clients.

I said before we'll be king to this decision not to use the best interest exemption after a lot of months of thinking and research and this is better for our advisors and its better for our clients. The best interest exemption is going to create confusion, it's got operational pay-in for clients, it's going to be inefficient and cumbersome for advisors. This is the best solution we believe for our clients and advisors.

Brian Moynihan

And if you look at the BRASS tax financials in to the third quarter of '16 we had $4.4 billion of revenue in our wealth management business. Of the 4.4 billion, 500 in total was brokerage and so this part of the business has been declining in favor of financial advice to the clients and to manage portfolios that meet the needs of the clients and have investment framers and decisions based on the client's goals. So the goals based method is the dominant method in our business and so you've seen a constant growth in asset management fees, net interest income and other sources of revenue and frankly a cost decline in the brokerage business across many years. So the SEC has an obligation to rule on this at some point and they will and we'll adjust to that there, but its consistent, we have been taking the business five or seven years.

Brennan Hawken

Sure, I get it and there's no question that commissions have been declining. It's just that when you look at some of the asset classes like alternatives and such it's hard to get everything to fit into a fee-based approach. So that was the gist of my question. But maybe going a different direction --

Paul Donofrio

Careful not to speak, just be clear we're not doing away with brokerage. Unless something changes in the industry and that's going to affect everybody, we're not doing away with brokerage. Brokerage is a very important part of our advisory relationship, and FA's will work that out with their clients what's best for them.

Brennan Hawken

Right. But if we take the logical conclusion that your approach here with retirement would be similar to taxable under the assumption and, I am making assumptions with all of this, but we all have to that the SEC comes out with a similar rule, then your option within to maintain brokerage is self-direct. And I could see how FAs might dislike the idea of having a component of their relationship move effectively away from them. So what has been the response from FAs of this idea that if we want to maintain brokerage it has to go the self-directed route, and has that tapped in on any of the worries that some of these brokers have seen much of their book shift over to discount brokers that would fit in that type of an approach?

Brian Moynihan

I thinking you've stated yourself that you're making a lot of assumption. I think let's let it play out. We have the biggest and most capable business in the world, making more money and having better margins than anybody else and I think we'll figure it out.

Operator

We’ll take our next question from Matthew Burnell with Wells Fargo Securities.

Matthew Burnell

Perhaps a bigger picture question, on your media call you were asked a question on Brexit, and it sounds like you do have plans in place for that which certainly makes sense. I guess given relative to your $53 billion cost target for 2018 and the fact that the negotiations seem to be starting to gear up early next year, how you’re thinking about the costs in the global markets and global banking businesses from Brexit if it ends up being a harder Brexit than a softer Brexit?

Paul Donofrio

I think it’s just too early to tell at this point. We don’t know how it’s all going to unfold in the UK and in Europe. We don’t know what the effect is going to be on our clients on the new rules. So as I said on the press call, we’ve developed plans based upon various scenarios and we’re just going to have to wait and see how everything unfolds to know what we’re going to do.

But as I emphasized on that call, today we are focused on our clients and as I alluded to, this impacts them too. So for now we’re just working with them, providing them loans, helping them raise capital to remove their money, manage risk and that’s what we are focused on.

Brian Moynihan

Just remember (inaudible) out of there, the markets business is about 20% of our expense base today. If that’s the entire business, so I don’t think the impact of Brexit in the overall company we would manage it without having any impact of any great magnitude. As it relates to the European business itself, we’ll have an impact if it costs us more but not to the whole company.

Matthew Burnell

And then just a quick administrative question, you mentioned on slide 9 that the non-performing loans in the commercial portfolio were increased by $340 million quarter-over-quarter. It seems like it's mostly in the energy and related space. Is that a US or are those US credits and what's your outlook for those balances going forward?

Paul Donofrio

Yeah with two credits, one in metals and mining, one in the US and if you look at the ratio it’s at a very comfortable level. So that doesn’t concern us.

If you note criticized assets were down in the quarter that's because these two credits that went NPL were already in reserved for criticized.

Operator

We'll take our next question from Vivek Juneja with JP Morgan. Please go ahead.

Vivek Juneja

Couple of questions, Paul, your deposits at the Fed declined pretty sharply almost 20% linked quarter, even though you had deposit growth and given that long-term rates are still very low. Can you talk a little bit about what drove that thinking?

Paul Donofrio

Yeah, we moved some cash in to securities. We're always the managing the trade-off between sort of liquidity, capital in terms of interest rate movements and returns and we just deployed some of that as I said in US treasuries because you can think about it going from one part of the government to the other. We just moved them to get a little bit more yield. We feel good about that move and we'll continue to optimize our cash on investment securities.

Vivek Juneja

Is that saying that you don't expect rates to go up that much, given that you move credit chunk at a time when long-term rates are pretty low?

Paul Donofrio

I'm not sure we're making any - we're not projecting any view of rates when we make that move, we're just balancing liquidity, capital and earnings. It's a big portfolio, we are always looking at to make sure that we feel good about where we are at any point in time.

Vivek Juneja

One more question, earlier you mentioned in response to a question that global markets was doing a better job managing the balance sheet. Could you give us some more color about what specifically they are doing?

Paul Donofrio

I’m not sure I really want to give much color out there. They’re doing the standard things you might do to optimize RWA, trade compression, looking at returns on various assets, and just optimizing.

Operator

We’ll take our next question from Marty Mosby with Vining Sparks. Please go ahead.

Marty Mosby

Wanted to ask you about two strategic balance sheet decisions; one is that there seems to be a lot more retention mortgages. So when we have these surges, we are not picking up as much mortgage fees but growing mortgage loans maybe a little bit faster. That is a shift, and do you think that will hold mortgage fees down and trade-off for further net interest income down the road?

Brian Moynihan

Yes you’ve got the dynamic but the route is as Paul was just answering last question here we continue to build cash that we need to put to work. These are our core customers, very high credit quality mortgages and pipeline is grown quarter-over-quarter and continues to grow on production passing capabilities. So you’ve got it right, the technical differences that are recognizing the upfront gain on sales of the mortgage and capitalizing the servicing, you see that come through NII over time. And the other dynamic remember is the MSR asset will continue to drift down because we have less and less third party servicing.

Paul Donofrio

And again I want to point out, we’ve done a lot of thinking about that, and we think maybe there is a near term impact on earnings but long term we think that’s a better strategy for our shareholders given the risk profile of the mortgages that were originating putting on the balance sheet.

Marty Mosby

And kind of in connection with that you talked about the big question on asset sensitivity, which is duration, expectation on your deposits. As you've gone through this cycle, and initially we all assumed that there was going to be a lot more volume run-off than the volumes just keep going higher. Have you adjusted that duration and is that part of why you are also comfortable putting on more mortgages that have that longer duration feel to it?

Brian Moynihan

In terms of the technical modeling NII we still use the same assumptions we've used. You could have great debate in our company whether we think those assumptions are conservative or not, but in terms of the NII modeling we've been very consistent in terms of what they got Marty the deposit data and what would change and how it would work.

I think the pragmatic answer is that we are - 90% of our consumer checking accounts are core transaction accounts, the primary checking account. Those balances are touching $250 billion plus. They've been doubled over the last seven or eight years. Those balances are the data cash flow of household and I don't think they are going to change much, but until you've got experience the model has to sort of look backwards as we say and so we'll see what happens. But so far those of us that take the side, this will be less sensitive if [won] let's just say that.

Marty Mosby

And then lastly, just a strategic utilization of capital, if you look at your allocation of capital and returns by business segment, you kind of do a weighted average, you come up with close to an 18% return. As profitability is getting higher that's getting further away from the overall return which is still around 10%. How do you envision trying to clean up either the capital positions or the overhang from overhead expenses that brings those two numbers maybe a little bit closer together?

Brian Moynihan

Marty, moving expenses down we talked about that earlier, that helps the returns. But we always have to remember that there is basically leave aside how the allocation works for the business, it works differently. But when you think about the 10% capital requirements for us 300 basis points or 3 percentage points of that cannot be put to use, it cannot take risk.

And so we're earning all our money on the 7% and so when you think about the weighted average of that, it comes out over 10 and that means that you're in a lot more on the seven even across the whole company, and so that's one of the difficulties. So how do we optimize that, we make that 10% less dollar volume if we can keep dollar volume down and keep increasing earnings you get. That's by all the discussion Paul had in response to the questions about optimizing the balance sheet.

Will we get expenses down, will we grow less risky earnings that generate an income, but it's a constant optimization, but the basic principal of people that we sometimes forget is that when you think about 10% only 30% of capital can take no risk and so basically you're in to cost of debt.

Operator

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

Gerard Cassidy

A question on your digital sales, obviously you've had 18% of total sales coming through digital channels and 25% through the mobile. Can you share with us what products you are having the most success with selling through these channels and which products proved to be more challenging?

Brian Moynihan

Well generally you should think that the products which are more straight forward like a card application, we build a nice auto loan execution that's kind of unique and because those things are fairly straight forward applications. Mortgage and things like that it really takes a lot more process around them. So, I'd say cards and autos are the [downward] part.

Gerard Cassidy

Is there any target of where you can get these sales to as a percentage of total sales? Can eventually 50% of sales come through the digital channel?

Brian Moynihan

I think it will continue to rise in terms of dollar amount, probably rise in terms of percentage. But remember as sales grow overall in the company, getting in to 50 means they have to win next race in the growth overall, but we are becoming more and more capable in delivering this and that's why you're seeing a nice growth and so we're applying deeply where it can really be the primary method and things like cards and auto are the easier place.

Gerard Cassidy

And then, finally, sticking with digital; is there any application in the digital channel, where you can have success like you are having in the consumer bank in the Merrill Lynch brokerage channel?

Brian Moynihan

Yeah, Merrill Edge is obviously across-the-board execution; their clients utilize that in Merrill and in US Trust and the broad consumer business. So, it's a broad execution and well recognized as being one of the leaders by the various authorities.

We believe and one of the things Jerry [Lockwood] and Keith Banks and Andy Sieg and John and other are working on is to increase our capabilities for both the advisor and the customer and the digital more or less stated in the (inaudible) business and so we think there is upside for us.

Again less customers so the leverage is not quite the same and that's why we spend a lot of our time around the consumer, and there's just less leverage and the advisor you have to think about that business because the advisors are core strength that we have to the customer that we have to have an execution which is universal between the advisors and the customers, they can all see the same thing. So we've got some great capabilities now My Merrill things like that. But we plan to continue and enhance them and continue to integrate them. So when they get to loans and deposits and things like that they are much more integrated over time. You can still see it all, but it's not where we want to be.

Operator

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

Q - Brian Kleinhanzl

I just had one quick question, and it's on the $52 billion expense target. If we got into an environment where you saw revenues come back more robustly near-term, could you still commit to that $53 billion target, meaning you have enough levers to pull or would you see yourself switching to maybe an efficiency ratio target if all of a sudden these revenues came back stronger? Thanks.

Brian Moynihan

Yeah, if you remember when we made that target it was in the context of 1.5%, 2% GDP growth economy much like we have now in the rate environment, incremental from where we have now. So I think the shareholders and this management team would be happy if we are having a discussion about revenue related incentives going up faster than that that would be good news for the company.

Operator

And it appears we have no further questions at this time. I'll return the floor to our presenters for closing remarks.