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Bank of America Corporation Fourth Quarter 2008 Earnings Call Transcript

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Seeking Alpha α

Bank of America Corporation Q4 2008 Earnings Call Transcript

Executives

Kevin Stitt – Investor Relations

Kenneth D. Lewis – Chairman, President and Chief Executive Officer

Joe L. Price – Chief Financial Officer

Analysts

Matthew D. O'Connor - UBS

Nancy Bush - NAB Research, LLC

Michael L. Mayo - Deutsche Bank North America

Bank of America Corporation (BAC) Q4 2008 Earnings Call January 16, 2008 7:00 am ET

Operator

Welcome to today's quarterly earnings announcement teleconference. (Operator Instructions) It is now my pleasure to turn the program over to Kevin Stitt. Please begin Sir.

Kevin Stitt

Good morning. This is Kevin Stitt, Bank of America Investor Relations. Before Ken Lewis and Joe Price begin their comments, let me remind you that this presentation does contain some forward-looking statements regarding both our financial condition and financial results. These statements involve certain risks that may cause actual results in the future to be different from our current expectations.

These factors include, among other things, changes in economic conditions, changes in interest rates, competitive pressures within the financial services industry and legislative or regulatory requirements that may affect our businesses. For additional factors please see or press release and SEC documents.

With that, let me turn it over to Ken Lewis.

Kenneth Lewis

Good morning. Welcome to today's program. (Operator Instructions) It is now my pleasure to turn the conference over to Kevin Stitt.

Kevin Stitt

This is Kevin Stitt, Bank of America Investor Relations. Before Ken Lewis and Joe Price begin their comments, let me remind you that this presentation does contain some forward-looking statements regarding both our financial condition and financial results. These statements involve certain risks that may cause actual results in the future to be different from our current expectations.

These factors include among other things, changes in economic conditions, changes in interest rates, competitive pressures within the financial services industry and legislative or regulatory requirements that may affect our businesses. For additional factors please see or press release and SEC documents. With that, let me turn it over to Ken Lewis.

Kenneth D. Lewis

Good morning. I don't need to tell you what extraordinary times we are experiencing. The economy and subsequently the credit markets literally hit a wall starting in September and culminating late in December with the greatest impact of my almost 40 years in banking. As you have seen in earnings reports so far, no body operating in the capital markets or lending to the consumer has been immune.

While 2008 was a very disappointing year, we still made a $4 billion profit even as we experienced more than $10 billion in capital market losses and $27 billion in credit costs. We suffered as the economy slowed materially as we are a long credit risk and our core activities of commercial and consumer lending as well as in our capital markets businesses. So the question on my mind and your minds is what are we doing about it?

We managed our risk position down during 2008, reducing wherever we could the relevant positions in every area. Due to illiquidity we could not get that risk down far enough. We continued to re-work our credit risk appetite and consumer. We have instituted LTV, debt-to-income ratios and other restrictions which are prudent in light of the times we are facing. This approach raises concerns with legislators and other constituencies that we may be pulling back on credit when consumers, small businesses and commercial customers need it most.

There is no doubt our overall appetite on credit risk is greatly reduced. Given the right costs and provisions here and throughout the industry how could it be otherwise? Nonetheless, as you will see in a few minutes, even as we seek to reduce risk we continue to offer loans and credit to individuals and small businesses and corporate customers. We originated $115 billion in new credit during the fourth quarter alone.

In our core company we have revisited and revised our unsecured underwriting terms and card terms, focusing on the programs that will produce better charge off results. In our commercial areas we continue to aggressively work on the credit book to reduce our exposures. During the last two years we have purchased sizeable credit exposures in our acquisitions of Countrywide and LaSalle which have added to our credit positions but we continue to restructure these operations and work to reduce risk levels.

We have been working on the integration plans for Merrill since September and now carry through those plans. So where does that leave us?

The core businesses at Bank of America continue to operate quite well. We continue to grow our franchise focusing on customers and associates. We have had healthy growth in checking accounts and deposits. Customers continue to seek us out as a company of strength. Metrics on customer favorability, brand awareness, customer satisfaction and purchase consideration all improved last year and we continue to be a leader in helping to find solutions to the credit crisis.

We are proud of this record. I think it is important for investors to understand that we do this because it is good business. The recession and credit crisis will end someday and people will remember that our company was there for them in hard times. That will be an essential element in our opportunity to return to the kind of profitability all of us want out of our company.

With that backdrop I will discuss fourth quarter earnings focusing mainly on the highlights across the company with some specific comments on individual businesses. Then Joe will go into more detail on certain issues including the actions we announced today, the capital markets, credit quality, net interest income and Merrill Lynch. Finally, we will touch on our thoughts for 2009 and discuss some of the near-term trends that will impact earnings.

On January 1 we completed the purchase of Merrill Lynch establishing a company unrivaled in its breadth of financial services and global reach. This merger reinforces Bank of America's position as a leading global financial institution. The merger creates, in our opinion, the most attractive U.S. consumer banking franchise with broad earnings, diversification and an attractive run deposit base. We are one of the largest wealth management businesses in the world with approximately 20,000 financial advisors and more than $2 trillion in client assets, a world leader in the global markets and corporate investment banking businesses particularly in the areas of lending, debt and equity writing, trading, liquidity, payments management, research and merger and acquisition advice and unparalleled in the number of commercial clients we touch through business lending and treasury services.

Longer term, the combination should be an earnings powerhouse with leading market share in almost all of its businesses. We are happy that John Thain has assumed a major role at Bank of America. John is in charge of Global Corporate Investment Banking as well as Global Wealth and investment management both of which will incorporate most of Merrill's businesses.

Since most of you are focused on the short-term let's turn to that. Last quarter we said that market turbulence, economic uncertainty and rising unemployment would take its toll on quarterly earnings and that has certainly been the result for the fourth quarter both at Bank of America and particularly at Merrill Lynch. The United States is currently in a severe recession affecting all sectors of the economy. Congress has passed the Financial Stabilization Plan as well as other programs put in place and are starting to stabilize credit markets and promote liquidity but at a

pace slower than any of us would like. We believe it will take time before any substantial benefits are seen in the health of the consumer and the impact on GDP growth.

Consequently, we think the prudent decision is to take our dividend to $0.01 rather than to wait and see how earnings will ball up in 2009. This reduction will preserve approximately $2 billion in quarterly dividends that would have been paid out. You saw in the release that Merrill Lynch experienced a fourth quarter loss of $15.5 billion that Joe will talk about in a moment. That loss materialized late in the quarter in December and presented us with a decision.

We went to our regulators and told them that we could not close the deal without their assistance. As a result, we have agreed to the issuance of $20 billion in tier-1 qualifying TARP preferred as well as the issuance of an additional preferred of $4 billion in exchange for an asset guarantee as essentially insurance protection of accrual of capital markets related to assets. We believe those actions were in the best interest of Bank of America and the financial system by limiting significant additional downside risk.

These actions also allow us to turn our attention to consolidating and recognizing the long-term strategic benefits of the two companies.

Turning to earnings, Bank of America in the fourth quarter reported a loss of $1.8 billion or $2.4 billion after deferred dividends or $0.48 per diluted share. However, for the entire year we did remain profitable earning $4 billion or $2.6 billion after preferred dividends.

As we experienced in the third quarter, earnings in the fourth quarter were seriously impacted by the headwinds of continuing high credit costs, severe market turbulence and losses weighted to one-time events. Although it is difficult to focus on what is going right at this time, I do think it is imperative to understand that most of our businesses do remain profitable for the fourth quarter. Both consumer and small business banking with earnings of $835 million and global wealth and investment management with earnings of $511 million.

Within global corporate investment banking business lending made $301 million and treasury services made $756 million. While these earnings in these businesses in some cases are substantially lower than earnings in normal times, they are still profitable even with the significant increases in credit costs, lower customer activity and public market headwinds.

An additional positive is that our retail businesses are experiencing a significant growth in deposits even as we operate in a lower interest rate environment. Average core retail deposits grew almost $12 billion or 2% including the expected run off in deposits at Countrywide. If you exclude the impact of Countrywide, retail deposits grew just short of $19 billion or 3.5% which we believe is a multiple of the overall market and was done while we maintained pricing discipline.

As we experienced during the MBNA integration, approximately $7 billion of deposits left Countrywide after initiating more rational pricing. The combination of deposit growth and anticipated stabilization of the markets should have a positive impact in 2009. However, more than offsetting the positives this quarter were several events related to the market turbulence.

These events included losses associated with CDM exposure, auction rate securities and legacy trading books; write downs in letters financed, CMBS and private equity, additional support of the Columbia cash funds and a challenging trading environment that impacted our trading results. In addition, the economy weakened in the third quarter as evidenced by rising unemployment, bankruptcies and continuing home price declines.

This weakening drove to additional credit deterioration across our loan portfolio causing us to add substantially to our line items for loan losses. Total revenue for the fourth quarter was approximately $16 billion on FTE basis, down approximately $4 billion or 20% from the third quarter. Net interest income rose 12% from the third quarter while non-interest income decreased 68%.

Driving much of the decrease in non-interest income was this impact of continued [multi] construction and trading account profits, equity investment income and other income. Non-interest expense decreased 6% from the third quarter driven by lower personnel costs primarily incentive compensation. Provision expense of $8.5 billion increased by $2.1 billion from the third quarter. Net charge offs rose $1.2 billion to $5.5 billion. The increase in reserves of approximately $3 billion brings the allowance for loan to lease losses to $23.1 billion or 2.5% of our loan to lease portfolio.

Earnings in each of our businesses were significantly impacted by all the factors I have just detailed. Let’s spend a few minutes discussing each of those businesses.

Global consumer and small business banking earned $835 million, down $504 million from the third quarter as stable revenue levels, lower expenses and lower taxes partially offset an increase in provision expense of $1.1 billion. The retail deposit story remains very positive as I have mentioned. Though the pace of growth is down from levels a year ago we continue to generate net new checking and savings accounts. For the second year in a row we grew net new checking accounts by more than 2 million. The recent drop in interest rates is driving a significant increase in mortgage applications, mainly refi's, which is providing a very good start to production levels for 2009.

Global wealth and investment management earned $511 million in the fourth quarter which is actually up from the third quarter and from the fourth quarter a year ago. Driving the comparison from last quarter was the fact that our support of the Columbia cash funds of $226 million was less than the support from the third quarter.

Global corporate investment banking lost $2.4 billion in the quarter as positive earnings and business lending was $301 million and treasury services was $656 million were offset by the market results and CMAS. Treasury services actually had a pretty good year with earnings this quarter up significantly from the third quarter. For the full year they earned $2.7 billion benefiting from core deposit growth and the flight to quality.

Business lending produced quarterly average commercial loan growth of $10 billion or 3% with revenue growth up 15%. CMAS lost $3.6 billion which Joe will address in a minute.

Not included in the three business segments is equity investment income of negative $387 million. These results were driven by minimal cash gains offset by lower valuations and impairments.

Now before I turn it over to Joe let me make a couple of comments about the current environment some of which reference my earlier comments. As I said, the economy is experiencing a severe recession. We are seeing home prices; rising unemployment and bankruptcies make it difficult to predict the timing of an economic rebound. We believe the economy will continue to be challenged throughout 2009 with some potential early signs of stabilization during the second half of the year. Currently employment weakness is expected to continue through a good part of 2009 as it lags the trend in GDP with unemployment rising in excess of 8%.

Credit quality will continue to be an issue in the next few quarters with provision and charge off's remaining at elevated levels and perhaps not improving until the latter half of 2009. Our tier-1 capital ratio is estimated to be 9.15% at year-end with a tangible common ratio of approximately 2.83%. As a point of reference if you consider the OCI associated with higher quality NBS that we expect will pay off in full and the restricted CCB shares that would add more than 40 basis points to the ratio or 3.27%. My point being that this ratio, while important, is impacted by certain factors that don't really influence how we run the business.

Joe will discuss what our pro forma ratios will look like given our actions so far this year. Given our economic outlook we still believe most of our core businesses can produce positive earnings for 2009 assuming a continued tight grip on expense levels across the company. We expect these earnings will also be accretive to capital in 2009. Remember, we sold some of our CCB investment in January which will result in an approximate pre-tax gain of $2 billion in the first quarter.

Most importantly we remain committed to serving our customers and clients while driving profitability during these tougher times. I know I am repeating myself here but these times continue to be increasingly difficult on all of us including our shareholders, associates and our customers. With the expanding investment in our company by the Federal government we intend to play a major role in restoring the economy of the United States to a healthy rate of growth. We will do this by providing credit to consumers, small and large businesses and state and local governments.

I have recently created a senior management team to oversee the Bank of America credit initiative which will meet weekly to review lending levels in each of the categories that I mentioned. This team will report monthly to the public on lending activity. This reporting will be in addition to any reports requested by our regulators, the Treasury or Congress. Going forward the role of banks must be to fuel the economy with credit while abiding by the inescapable transparency and accountability inherent in the use of public money for any purpose.

Bank of America acknowledges the responsibilities that accompany the use of public funds and stands ready to play the role as the leading bank to help refurbish the economic recession and restore America as the world's leader in business innovation and progress. Our acquisitions of both Countrywide and Merrill Lynch were directed at strengthening the franchise but also contributed to marketplace stability and we remain a partner for our customers and clients critically providing credit, helping them restructuring their balance sheets and giving them advice on how to best navigate their individual financial situations.

Most of you I think are well aware of our home loan modification program that is projected to modify over $100 billion in mortgages and over three years keep up to 630,000 borrowers in their homes. We have 6,000 associates in our home retention division working with borrowers. During 2008 the home retention division completed over 300,000

workouts. We are working out two troubled loans for every one on which we foreclose. Bank of America last year provided more than $150 billion toward lending, investing and grant dollars to America's small businesses and communities and to support lower to moderate income individuals and communities. Bank of America's $1.5 trillion commitment in 10 years is unparalleled in the business.

Business lending remains strong and we have continued making loans to states and municipalities in a time of extraordinary uncertainty. Our team is doing everything they can to operate as efficiently as possible and to build the earnings power of the franchise so when conditions improve you will see the benefits.

With that I will turn it over to Joe to expand a bit on the quarter as well as some of the points I have references.

Joe Price

Thanks Ken. As Ken mentioned we entered into several agreements with various government agencies in light of Merrill Lynch's fourth quarter loss. These actions will replenish capital and provide protection, essentially insurance, against significant downside risk on a pool of $118 billion in capital markets related exposures. Now in doing this we have insulated in large part future significant losses from the asset classes that drove Merrill Lynch's loss. This wrapped pool includes assets that when combined with other losses where exposure no longer exists represents some 2/3 of Merrill Lynch's fourth quarter loss.

In doing so we expanded the coverage to include substantially similar exposures on the Bank of America platform as these assets will be managed together in the ongoing company. From the standpoint of the Bank of America capital markets loss in the fourth quarter the pool includes assets that drove about the same percentage of our losses. Generally speaking, the wrap covers domestic, pre-disruption or legacy leverage loans and commercial real estate loans, those that were largely acquisition related facilities originally intended to be securitized, CDO's, financial guarantor counter-party exposure, certain trading counter-party exposure and certain investment securities.

Terms of the agreement are that in exchange for us issuing preferred stock of $4 billion which pays a dividend of 8% and warrants, the combined government agencies will absorb 90% of the losses on this pool after the initial $10 billion first loss that we retained. We retained 10% of the losses in excess of the first loss division. We will continue to manage these assets in the ordinary course of business and retain the income from the aggregate pool.

There are some more details in our filings on the specific provisions. While platforms still carry market and credit risk, while entering the agreement we have limited the downside on much of the capital market legacy cash positions as well as select counter-parties in exchange for the first loss position and a premium. Assets included in the wrap will carry a 20% risk weighting for capital purposes.

Let me now turn to earnings and begin by elaborating a bit more on fourth quarter results before turning to credit quality, capital and Merrill Lynch. Turning first to GCIB, and more specifically capital markets and advisory services.

As Ken mentioned this was one of the most difficult capital market environments in history and the fourth quarter was particularly severe. Prices continue to decline across a broad spectrum of asset classes. Global de-leveraging accelerated. Volatility and illiquidity continue to disrupt equity and credit markets and correlation trades experienced significant diversions, all of which made for an incredibly challenging backdrop in addition to normal fourth quarter seasonality.

Now all this led to very disappointing results. Net loss of $3.6 billion in CMAS. On a positive note, investment banking fees were up 30% from the third quarter to $618 million. Now we would characterize our market disruption charges this quarter as approximately $4.6 billion. These charges continued to be centered in CDO related write downs as well as couple of other areas.

Let me start with leverage lending where we ended the quarter with exposure of $3.6 billion which is all funded, down $2.9 billion from September. $1.7 billion of the reduction was the transfer of bonds to the corporate investment portfolio where they will be carried as an investment. The remaining reduction was a combination of sales, write downs and terminations. Legacy or pre-disruption exposure is down $2.3 billion and is carried at $0.67.

During the quarter we wrote down an additional $425 million versus $648 million in the first nine months of 2008 as valuations continue to erode due to spread widening. On the CMBS side we ended the year with $7.6 billion in exposure, down 7% from the third quarter of which $6.9 billion is funded. As always, I remind you approximately 80% is comprised of larger ticket, floating rate debt most of which is acquisition related. This floating rate debt was written down approximately $500 million.

We also recorded approximately $328 million of losses associated with equity investments we made in acquisition related financing transactions. There were several other legacy books where we continued to record losses including $740 million in structured credit trading of which about $400 million was counter-party valuation losses. This book, as

well as our other credit products, experienced losses as cash spreads gapped out disproportionately and extreme dislocations and basis correlations occurred.

We also lost $589 million on non-U.S. high grade NBS as the severe spread movements were not limited to the U.S. Now finally in the supplemental packet you can see our CDO and sub-prime related exposure along with the changes during the quarter where we recorded losses of $1.7 billion.

The losses were largely comprised of approximately $848 million of super senior CDO write downs, a charge of approximately $400 million to reflect the counter-party risk associated with our insured super senior position and additional write downs of $423 million mainly on positions we retained from CDO liquidations.

At the end of December our un-hedged, sub-prime super senior related exposure dropped to just below $1 billion, $980 million to be specific, while bonds retained from the liquidations were about $2 billion. Un-hedged super senior related exposure including the securities retained from liquidations now total $5.3 billion. Our remaining hedged exposure of $1.5 billion which is all high grade is carried at $0.41 on the dollar and approximately 71% of the wrappers are from mono lines.

This exposure is included on the schedules in the supplemental package along with the relevant information.

Before I move off these legacy exposures let me say that the domestic CMBS and leverage loans as well as the CDO's both hedged and un-hedged are now covered under the government wrap.

As I told you last quarter we agreed to offer to buy back auction rate securities that we sold to certain customers. During the fourth quarter we actually repurchased approximately $4.7 billion bringing our total holdings to $7.6 billion. Valuation declines in the quarter cost us approximately $410 million of which most was recorded in the GCIB unit. Our estimated remaining repurchase commitment was $675 million at year-end.

Now let me switch to credit quality. We began seeing a decidedly negative impact on our customers from the slowing economy, particularly the consumer and these pressures accelerated in December. This is evident in spending patterns as well as credit performance. As result, fourth quarter provision of $8.5 billion exceeded net charge off's resulting in the addition of approximately $3 billion to the reserve. Reflective of continued economic stress on the consumer, reserves were added for most consumer related products, most notably home equity, credit card and consumer lending.

Now the reserve addition also includes $750 million associated with the reduction in expected principle cash flows on the Countrywide impaired portfolio driven by continued deterioration in the economy and the home price outlook. On the commercial side we added approximately $460 million to the reserves for small business, broad based deterioration in the non-real estate commercial portfolios as well as the home builder portfolio.

This commercial increase is reflective of a slow down in consumer spending, continued global financial markets turmoil and housing value declines. Our reserve now stands at $23.1 billion or 2.5% of our loan and lease portfolio. On a held basis, net charge off's in the quarter increased 52 basis points from the third quarter to 2.36% of the portfolio or $5.5 billion. On a managed basis, total net losses in the quarter also increased 52 basis points to 2.84% of the managed loan portfolio or about $7.5 billion.

Managed net losses in the consumer portfolios were 3.46% versus 2.89% in the third quarter. Managed consumer credit card net losses represent 54% of total consumer losses. Managed consumer credit card net losses as a percent of the portfolio increased to 7.16% from 6.4% in the third quarter. 30 day plus delinquencies in managed consumer credit card increased 79 basis points to 6.68% while 90 day plus delinquencies increased 28 basis points to 3.16%.

We have continued to see increased delinquencies across our card portfolio even more so in the states most affected by housing problems. California and Florida make up a little less than a quarter of our domestic consumer card book but represent about 1/3 of the losses. Clearly with unemployment levels projected to go beyond 8% in the U.S. we would expect the consumer credit card net loss ratio to increase as well and probably exceed unemployment levels by at least 100 basis points and be further impacted by decreasing loan levels.

Credit quality in our consumer real estate business also continued to deteriorate from the third quarter. Our largest concentrations are in California and Florida which combined represent about 40% of the home equity portfolio and represent about 65% of the losses. Home equity net losses increased approximately $149 million to $1.1 billion or 2.92% versus 2.53% in the prior quarter. 30 plus performing delinquencies increased 47 basis points to 1.75% while NPA's increased 41 basis points to 1.86%.

We have seen HELOC utilization rates tick up about 200 basis points to 52% driven by additional draws and slower payments. Our ending home equity balance of $153 billion was up slightly during the quarter. New business and

increased utilization net of pay downs contributed approximately $5.1 billion in growth which was partially offset by closed accounts and charge offs.

As we said last quarter with the increased economic and credit pressures we continue to believe that the loss rate will cross the 4% mark in 2009. Our residential mortgage portfolio showed an increase in net losses to $466 million or 73 basis points for the quarter. That would be 62 basis points net of the insurance wrap that we have on that product. Excluding our community investment act portfolio and that portfolio totals 7% of the residential book; losses would have been $340 million or 57 basis points so about 46 basis points net of both the CRA and the insurance wrap.

We have continued to see increased delinquencies and losses across our portfolio, again even more so in the states most affected by the housing problems. California and Florida, which combined comprise 42% of the balances drove 63% of the net losses. Although approximately $119 billion or 48% of our residential mortgage portfolio carried the risk mitigation protection it does not cover our CRA programs.

$70 million of net losses this quarter were covered by insurance which reduces the net losses to 62 basis points on the portfolio versus the reported 73 basis points. I should note that we continue to reduce home loan balances through sales or by converting them to securities as examples of many actions taken to fortify liquidity. This has the effect of bringing down the average loan balances thereby negatively impacting the reported loss rate. However, having said that we do see continued deterioration and worsening economic conditions could drive a loss rate in excess of 100 basis points net of our insurance.

Turning to our other consumer portfolios, the auto portfolio at the end of December was about $26 billion in loans. Net losses in the quarter were $155 million or an annualized 2.44% of the portfolio up from 1.68% in the third quarter. Although a portion of this increase was due to seasonality in this business, reduced collateral values as well as economic stress on the consumer also contributed to the higher losses.

Within car services we have the consumer lending business that has about $28 billion which is mostly comprised of unsecured consumer loans. Largely due to increased unemployment and increased bankruptcies this portfolio is also experiencing rising delinquencies and losses. Net credit losses were 10.37% in the fourth quarter, up 193 basis points over the third.

Loss rates have also been impacted by tightening in underwriting criteria resulting in a significant slow down of new loan production. Like our own portfolios, California and Florida continue to have out-sized delinquency and loss contributions in relation to the outstandings. During the quarter we increased reserves on this portfolio by about $450 million to a level of around 12.3% of ending loans.

Switching to our commercial portfolios, new charge offs increased $399 million in the quarter to $1.36 billion or 159 basis points, up 46 basis points from the third quarter. The deterioration this quarter was broadly spread across various businesses although on a semi-positive note small business had the smallest increase, i.e. about $35 million, we have seen in several quarters. Net losses in small business, which are reported as commercial loan losses, increased to 11.5%.

If you exclude small business from commercial domestic our total commercial loss rate is about 99 basis points. Further excluding commercial real estate where losses have been concentrated in home builders, the loss rate is 65 basis points.

As we have discussed before, many of the issues in small business relate to the rapid growth of the portfolio over the past few years which is now compounded by current economic trends. The continued increases are consistent with the seasoning of these vintages and while clearly too high they are generally in line with our forecast from last quarter.

Reservable criticized utilized exposure in our commercial book increased to 8.9% of the book from 7.45% at the end of the third quarter. The increase is scattered across industries, lines of businesses and products. Commercial NPA's rose $1.7 billion to $6.8 billion. Nearly 56% of commercial NPA's was in the commercial real estate business spread across home builders, retail and apartments.

Let me move off credit quality and discuss net interest income. Compared to the third quarter on a managed and fully tax equivalent basis, net interest income was up $1.5 billion of which core, which excludes our trading related margin, represented $994 million. The increase in core NII was driven mainly by lower short-end rates on market based funding and core deposit products.

The core net interest margin on a managed basis increased 16 basis points over third quarter to 3.95% due primarily to the improved rate environment. As you can see in our material our interest rate positioning is now asset sensitive to parallel moves in rates compared to our liability sensitive position at the end of September. The change in sensitivity is primarily due to the changes in the forward curve as well as the absolute low level of rates.

Due to this low level of rates some of our longer term assets are re-pricing faster while our shorter term liabilities have already or are unable to re-price much lower. Given how low rates are an asset sensitive position makes sense as we are positioned to benefit as rates rise in the future. While we are asset sensitive to parallel moves in interest rates we continue to benefit from curve steepening.

As a heads up we expect net interest income to drop in the first quarter for seasonal reasons as well as the negative impact of lower interest rates on our asset re-pricing.

Now let me switch and talk about fourth quarter results for Merrill Lynch. As Ken mentioned Merrill Lynch's fourth quarter preliminary results totaled $15.5 billion loss. In our supplemental material we have included a preliminary P&L and balance sheet. The Merrill Lynch data we are providing today is a preliminary overview as Merrill's ordinary and usual process for analyzing the numbers continues. Once the results are fully complete Merrill Lynch and Co. will file a form 10K for 2008 so there will be more information in that report for you.

Before I take you through the details on the large items let me say that the difficult capital markets environment, particularly the severe impact late in the fourth quarter, hit the Merrill Lynch platform very hard. As asset prices continued to decline across all categories, volatility and illiquidity spread throughout the markets and the correlation trades were really hit hard. All this led to very disappointing results.

However, starting off on a positive note, Global Wealth Management continued to deliver solid results despite the environment with global private client net revenues down only 10% sequentially and even less in the U.S. advisory portion of the business, a testament to the quality of the franchise. Certain other businesses also performed relatively well such as investment banking down only 4% sequentially and commodities which was up substantially on strength in trading gas and coal in Europe.

Now in the fourth quarter Merrill Lynch overall reported negative revenues by $12.6 billion. Let me take you through the principle drivers of those losses and the related remaining exposures. Starting with the transitory leverage lending exposures, charges totaled $1.9 billion during the quarter driven by several credits under significant duress. Remaining exposure in that transitory book totaled $5.6 billion carried on average at $0.42 on the dollar or $2.4 billion on a market value basis. The portfolio is comprised mainly of less liquid positions such as revolvers and bridge loans.

Of this total market value about $1 billion is domestic and covered under the wrap. The remaining commercial real estate exposure excluding the First Republic portfolio is $9.7 billion. Commercial real estate losses were $1.1 billion of which $475 million related to whole loan conduits. The remaining whole loan conduit exposure is $3.8 billion and is currently carried at $0.72 on the dollar of which about $2 billion is covered under the wrap. The remaining $600 million of losses were due to real estate related debt and equity investments involving smaller credit in the [DMDA and the Pack Rim]. The remaining exposure of these investments was $5.7 billion at the end of the year.

The U.S. super senior ABS CDO losses were $369 million this quarter and remaining un-hedged exposure was $800 million. It is carried about $0.14 on the dollar. The hedged loan exposure is just over $1 billion and it is carried at about $0.20 on the dollar. Both of these are to be covered under the wrap. Merrill Lynch experienced a loss of about $300 million on the financial guarantors covering the U.S. super senior ABS CDO's. The remaining receivable from guarantors on that portfolio is $1.5 billion and this exposure is also covered under the wrap.

Regarding credit default swaps with mono line financial guarantors excluding those I just mentioned covering the U.S. ABS CDO's, total notional was $50 billion with a mark to market before adjustment for counter-party risk of $12.8 billion, $7.8 billion after the counter-party risk adjustment. As part of Merrill Lynch's correlation trading and credit trading books they have entered into various derivative contracts with mono line insurers to hedge risk in the portfolios. Of the notional amount of the insurance of about $50 billion, one half relates to CLO and various hybrid basket trades and the other half relates primarily to CMBS and RMBS on which the underlying collateral varies from AAA to BBB.

To date, Merrill has taken credit valuation adjustments of approximately 39% on the receivable balance. Both the remaining receivable balance as well as the remaining net notional are covered under the wrap. CBA taken during the fourth quarter on these exposures totaled about $3 billion.

Merrill Lynch also recorded about $1.2 billion in losses on their U.S. banks investment portfolio during the quarter. This portfolio had a year end market value of $10.4 billion with $9.3 billion of cumulative loss adjustments recorded in OCI reducing their shareholder's equity at year-end. As you know, OCI gets adjusted to purchase accounting so carrying or market value will be equal to our basis at acquisition. The remaining market value 95% is covered under the wrap.

Counter-party valuation costs on the derivatives book other than the mono lines I talked about just a minute ago during the quarter were almost $2.5 billion. This cost included approximately $800 million due to the narrowing of

Merrill Lynch spreads due to the merger announcement which would normally provide an offset but obviously in this case went the same direction. There is about $17 billion of selected counter-party notional on derivatives, $3.2 billion of which is mark to market and is covered under the wrap previously discussed.

Write downs on private equity and principle investments totaled $1.7 billion driven by valuation adjustments on private holdings and marks on the public holdings. Other write downs included $2.3 billion in goodwill impairment related to the fixed income and investment banking businesses.

In addition to pressure on legacy exposures, the market dislocation and contagion caused many businesses to have very weak results particularly credit, proprietary trading and principle investments. As I mentioned earlier while large write downs occurred in the fourth quarter we have limited the significant downside risk in these asset classes under the wrap.

We will provide more details on the Merrill Lynch exposures and what portion is covered under the wrap in future SEC filings.

Since we closed the acquisition of Merrill Lynch on January 1, the results I just detailed are not reflected in our fourth quarter. Integration efforts continue to move ahead and we remain confident in the long-term prospects of the combined company. So let me quickly cover some of the merger specifics.

We issued approximately 1.4 billion Bank of America shares at an exchange rate of .8595 for each Merrill share. I'll give you some preliminary purchase accounting estimates but realize they will probably change somewhat as we are currently finalizing those.

From an accounting standpoint under the revised purchase accounting guidelines we will mark Merrill Lynch's balance sheet to fair value levels as of January 1. As required under FAS 141R the total purchase price for the transaction will be reported for accounting purposes as the value as of the close or $29.1 billion. That includes the $20.5 billion in common shares and the $8.6 billion in preferred equities.

Subtracting Merrill Lynch's estimated tangible book value, adjusted for the impact of the preliminary purchase accounting of approximately $19.8 billion, and $3.9 billion in identifiable intangibles net of tax, results in goodwill of about $5.4 billion. Other changes in purchase accounting adjustments from our prior disclosures include using the actual year-end number for Merrill Lynch's total shareholders equity which at $20.6 billion reflects the fourth quarter loss and incorporating a write down on Merrill Lynch's debt of $15.5 billion reflecting fair value given Merrill Lynch's year-end credit spreads.

As you can see, total assets at Merrill Lynch at the end of December before purchase accounting marks were $663 billion. Loans held for investment net of the allowance were $58 billion and deposits were $98 billion. Expect some shifting around of what is in the accrual book versus the market books as we move further down the path of consolidating operations and management.

You can see from the material our updated restructuring costs of $3 billion pre-tax or $2 billion after tax is consistent with our initial estimates. At this point we expect to hit our target cost save of $7 billion pre-tax and it looks like we will get more in 2009 than expected. We originally indicated 20-25% but now it looks like we could be north of 35%. This will likewise accelerate our merger charges a little.

Under FAS 141R the $2 billion of after-tax restructuring charges will be reported through the income statement as restructuring expense through 2011. The restructuring charge for 2009 is estimated to be approximately half of the total spread somewhat evenly over the four quarters.

Given the size of the balance sheet, adding Merrill Lynch to Bank of America would reduce Bank of America's tier-1 capital by approximately 45 basis points. 8.7% on a pro forma basis which includes the $10 billion of preferred that funded January 9 that was part of the initial TARP equity program. Adding incremental preferred issuance we announced this morning plus the risk weighted asset adjustment due to the asset wrap, pro forma tier-1 would be approximately 10.67%. Estimated risk weighted assets from Merrill after purchase accounting adjustments of approximately $379 billion for your reference.

Adjusting for the wrap, combined risk weighted assets dropped by around $70 billion.

As a reminder, we also strengthened tier-1 somewhat two weeks ago with the sale of some of our investment in China Construction Bank, generating a pre-tax gain of approximately $2 billion.

Turning to tangible common, as Ken mentioned earlier we ended the quarter at 2.83%. On a pro forma basis including Merrill Lynch and the other actions that ratio would be 2.66%. If you consider the same adjustments that

Ken mentioned earlier related to higher quality debt securities and our restricted shares of CCB you could add about another 30 basis points to the ratio so call it just under 3%.

We are clearly comfortable running the company at this level of tier-1 realizing that it is in excess of what is appropriate and more normal times is needed. The tangible ratio, while adequate, will be rebuilt through earnings given the dividend action we announced this morning. While I am not going to predict capital ratio levels at the end of March, we will continue to be more efficient with the use of our balance sheet including the combined trading books of Bank of America and Merrill Lynch.

From an earnings perspective we believe Merrill Lynch on a GAAP basis will be dilutive to Bank of America's earnings over the next two years due to what we believe will be below normal investment banking and trading environments. While we have not formally guaranteed the debt of Merrill Lynch we clearly view it as supporting a critical part of our ongoing operations.

Before turning it back to Ken let me say a couple of things about liquidity. Parent company liquidity remains strong with time to required funding at 23 months on a pro forma basis with Merrill Lynch. It is actually 37 months before Merrill Lynch at the end of the year. The additional actions today, meaning the TARP capital, will add an additional 7 months to that for our parent company liquidity. Also during our fourth quarter we rated nearly $20 billion in debt under the TOGP primarily at the holding company level to ensure robust and excess liquidity to prepare for the Merrill Lynch merger. Our primary bank [BANA] is running the highest levels of excess cash in the company's history on a daily basis and although somewhat inefficient from a margin perspective it is prudent given the environment.

Positive inflows remain strong and customers clearly prefer to keep cash in safe and liquid form. This is one of the strongest aspects of our franchise and where we truly benefit from being the largest coast-to-coast financial institution.

With that now let me turn it back to Ken.

Kenneth Lewis

Thank you Joe. Going into 2009 let me reiterate that there is considerable uncertainty about the economic environment and the ongoing health of the consumer. Due to that uncertainty we won't go into the detail we have provided in the past as far as our expectations for 2009. However, those banks with market presence and strong balance sheets can weather and even benefit from the situation and we do feel good about our relative position in our businesses versus the competition.

Making pro forma revenue comparisons between 2008 and 2009 is difficult given the market disruptions and losses experienced by both companies in 2008. However, we believe core net interest income will benefit given the favorable rate environment. However, trading net interest income will drop given the targeted reduction in the trading books and as was mentioned before we expect net interest income in the first quarter to be down due to seasonal impacts as well as lower pricing of assets but then positive in comparison in each of the quarters thereafter.

Non-interest income will obviously grow if you assume some stabilization in the markets but I will let you hazard a guess on the health of the global markets in 2009. One area we do have control over is non-interest expense. For 2009 we originally targeted approximately 20% of the $7 billion in cost savings from the Merrill integration and we now believe, as Joe said, we can get closer to 35% or even north of 35%.

Additional cost savings from Countrywide and LaSalle should also have a positive impact on expense levels. Consumer credit quality will continue as a headwind due to what appears to be further deterioration in housing and unemployment levels and its subsequent impact on consumer asset quality.

Similarly, we would expect to see challenges in the consumer dependent sectors of our commercial portfolio. Given this scenario, for the next several quarters we would expect net losses to be at or above levels we experienced in the fourth quarter. While provision is dependent on future credit losses, everything we are seeing currently points to no relief in provision for at least the next several quarters.

Clearly a real positive for us in 2009 would be for the trading environment to settle down. Under that scenario we can manage through the tough credit environment which unfortunately is with us for the next few quarters.

With that let me open it for questions.

Question-and-Answer Session

Operator

(Operator Instructions) The first question comes from the line of Matthew D. O'Connor – UBS.

Matthew D. O'Connor - UBS

How should we think about all this non-common equity that you and other banks have? At the end of the day we think about the lion defense against losses it is common equity, loan loss reserves and pre-provision earnings and all this doesn't really address any of that and the fact the $3 billion you paid up per year in dividends reduces the common equity. I can appreciate it helps from a liquidity side which is already very strong at Bank of America but does it matter having 8.5% tier-1 versus 10% tier-1 when the common equity is still relatively low?

Joe Price

As I made in the comments, obviously tier-1 is a critical measure and it is one that we clearly manage by because it gives the composition of the asset mix much more specific to our institution. Having said that, you have heard us say before every ratio has its day in the sun and is critical at different points in the cycle. We clearly view the common equity ratio as something that needs to be focused on. It affected, as I mentioned before and Ken mentioned by certain other attributes that go into OCI and all, while we feel very comfortable it is adequate at the level it is that is one of the areas we have to focus on to build and that was, as I mentioned before, why the dividend reduction will help rebuild that.

Matthew D. O'Connor - UBS

Obviously to rebuild the TCE you can have organic earnings, you can change the balance sheet as you mentioned, capitalize as well on the common side but can you talk about how meaningful some of the balance sheet reductions might be as we think about 2009? I can appreciate a lot of prepayment fees are being pretty low right now and it is tough to divest these assets but what are some expectations on how meaningfully you can reduce the balance sheet?

Kenneth Lewis

Just look at what the pro forma that most though in terms of what the balance sheet would look like and it is probably $300 billion less than what you would have thought it would have been so that gives you kind of an idea of what you can do in a fairly short period of time.

I'll turn it over to Joe after that.

Joe Price

I think a lot of the securities businesses I think still have sizeable opportunity because traditionally those businesses weren't necessarily focused on for aggregate gross balance sheet level given the matched books and some of the natural risk offset so you kind of managed on a net risk basis and allowed some of the balance sheet to get bigger. That was some of the areas the team focused on coming into year-end but it has clearly still got some opportunity and that doesn't really have a material impact on the business flow and business activity. So we think there are areas clearly like that which will help us.

Matthew D. O'Connor - UBS

Separately, the Countrywide marks have been pretty aggressive at the time when the deal closed. Any update on how you are feeling with those marks at this point?

Joe Price

I don't know if you caught it, I referred to it in the comments and Kevin has got it at the back of the presentation, a package that kind of shows you the impaired loan pool performance. We did update those marks. We kind of re-forecasted cash flow and we added about $750 million of additional marks to the impaired loan portfolio. That was focused principally in the pay option ARM product which is the one that we have always kind of viewed as some of the biggest downside risk.

Operator

The next question comes from Nancy Bush - NAB Research, LLC.

Nancy Bush - NAB Research, LLC

Could you just tell us the $118 billion that is being back stopped here says it is "primarily for Merrill Lynch." Could you just put out what is from Merrill Lynch and what is from legacy BAC?

Joe Price

Don't hold me to this exactly but think of it as 75% Merrill Lynch legacy assets and about 25% of similar types of assets off the Bank of America platform.

Nancy Bush - NAB Research, LLC

Is there something special about those? Or did you just decide to throw them in because the risk factor? I'm trying to sort of separate out this TARP investment and what happened at Merrill and what happened at legacy BAC to trigger this.

Joe Price

Let me give you a personal response and Ken may want to elaborate. We were going through the process and we looked at first of all what drove the losses on the Merrill Lynch platform during the fourth quarter and what were the remaining risk assets. That was the focus of the process. There were certain assets that just fall out of the criteria for the wrap based on the different agency criteria. We then said we had similar assets on the Bank of America platform and since you operationally manage some of this stuff together it would not necessarily make sense to have overlapping positions in the same credit name so we reached across and said what are the similar Bank of America capital markets assets. That is kind of the process we went through to devise what would be [inaudible].

Nancy Bush - NAB Research, LLC

Ken, a question for you and I think everybody is trying to grapple with this morning. What if anything was missed in due diligence of Merrill Lynch that brought us to this point? If you could just elaborate on your view of that.

Kenneth Lewis

In a nutshell, much, much higher deterioration of the assets we identified than we had expected going into the fourth quarter. So our forecast of losses and Merrill Lynch's forecast of losses and frankly I would think most anybody in the capital markets business would have forecasted a lower loss rate than what we saw. So it wasn't an issue of not identifying the assets. It was that we did not expect the significant deterioration which happened in mid to late December that we saw.

Nancy Bush - NAB Research, LLC

We know that the TARP investments are necessary right now to get us through this period but I'm sure that you don't like your company being called a ward of the state. Much of the banking industry is coming to that but for BAC when do you anticipate you will be able to get out from under all these government "investments?"

Kenneth Lewis

I wish I knew because then I would know what the economy is going to do over the next few years. Clearly as soon as possible, to kind of reinforce your point. If you just start looking at pre-provision and normal capital markets, this company will generate huge amounts of profit when we get a normal economic environment. Not even a great one, just a normal one. It is almost directly correlated to how fast do you think the economy will come back.

Operator

The next question comes from Michael L. Mayo - Deutsche Bank North America.

Michael L. Mayo - Deutsche Bank North America

What is pro forma tangible book value? I guess it is $11.44 at the end of the fourth quarter but including Merrill Lynch what would that be?

Joe Price

I have been thinking about ratios so much let me get Kevin to come back.

Michael L. Mayo - Deutsche Bank North America

Just to follow-up to that last question, were you able to walk away from the Merrill Lynch deal? If it was so much worse as of mid December couldn't you say hey let's renegotiate or let's do something?

Kenneth Lewis

Let me just kind of take you through that. It is a very legitimate question. As we saw the anticipated fourth quarter losses accelerating we did evaluate our rights under the merger agreement and during that time we spoke to and were in close coordination with officials from both Treasury and Federal Reserve. The government was firmly of the view that terminating or delaying the closing of the transaction could lead to significant concerns and could result in serious systemic harm. A re-pricing, assuming it could be agreed, would have required a new stockholder vote both at Bank of America and at Merrill Lynch and therefore it would have been delayed by at least a couple of months. That would have led to considerable uncertainty and could have well cost more than the re-pricing we would have saved.

I think in recognition of the position that Bank of America was in, both the Treasury and Federal Reserve gave us assurances in December that we should close the deal and the government would provide the assistance we were talking about particularly putting a fence around some of the assets we were most concerned about. So in view of all those considerations and in view that strategically Merrill Lynch remains a solid franchise, we just thought it was in the best interest of our company and our stockholders and the country to move forward with the original terms and the timing.

Michael L. Mayo - Deutsche Bank North America

What I think I hear is you are kind of helping out the country and doing a little bit of a favor, so why in turn is the company put in some chains in terms of the executive compensation limits? It seems like the regulators got tougher on Bank of America as a whole because you went out of your way to kind of make Merrill Lynch work. Am I misreading something here?

Kenneth Lewis

I think you have to think about it in a broader perspective that there are going to be issues with others and there have been issues with others and we did think we were doing the right thing for the country but at the same time from the government's perspective they have got to have some template and not have us be seen as being given favoritism.

Kevin Stitt

The tangible book value including the Merrill Lynch shares is just under $10. Call it $9.93 or something like that.

Michael L. Mayo - Deutsche Bank North America

So it goes down by about $1.50 or so.

Kevin Stitt

Right.

Michael L. Mayo - Deutsche Bank North America

When do you think you will be building up book value next quarter? All things considered? I guess the question is do your pre-provision, pre-tax profits help offset the credit losses? How do you think about that?

Kenneth Lewis

This is almost a facetious thing to say but if I could annualize the first two weeks it would be building quite a bit. But it has only been two weeks and you wouldn't know. Yes, we would but obviously we are subject to what happens in the economy.

Kevin Stitt

Thanks everyone.

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User 265729

So, are you guys going to steal lunch money from little kids on their way to school next?

WSeeley

If Mr. Lewis is as committed to restoring the U.S. economy as he claims in this press conference, then why did he acquiesce in paying $4 billion in bonuses to Merrill Lynch personnel (now a Bank of America subsidiary), while BOA only earned $4 billion in 2008 and ML lost $27 billion? As a BOA shareholder who has seen his $50,000 investment shrink to $5,000 (90% loss), I am appalled by this reckless decision. Mr. Lewis should be fired.

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vaughn

Merill had the contract obligation to pay out "bonus", a devise designed to tie up key employees for at least a year.

My guess is that had BoA chosen (if BoA had the power to do so) to pay out the merill bonus after the merger, then the $4 billion would be treated as BOA expenses and enlarged the quarterly loss for 1Q 2009. Let Merill pay out in 2008 and BOA would effectively record the $4 billion in goodwill, which can be amortized over certain period (20years?).

The bottom line is: Contract is contract and the so called bonus must be paid out by merill. Let merill do it will reduce the complexity of political consequence and can certainly help to simplify accounting treatments for BOA. That seems to me amounts to one stone for two birds. Ken Lewis, anyway, cannot block the payment. It might be better off let John Thain handled it and took the consequence of it while reducing the expense for 1q 2009 of BOA.

On Feb 07 12:44 PM WSeeley wrote:

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> claims in this press conference, then why did he acquiesce in paying
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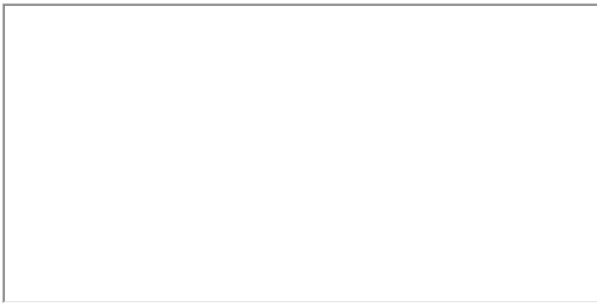

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