Form 10-Q for BANK OF AMERICA CORP /DE/

6-Nov-2008

Quarterly Report

Management's Discussion and Analysis of Financial Condition and Results of Operations
Table of Contents Page

Throughout the MD&A, we use certain acronyms and

abbreviations which are defined in the Glossary beginning on page 171.

Table of Contents

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This report on Form 10-Q contains certain statements that are forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as "expects," "anticipates," "believes," "estimates" and other similar expressions or future or conditional verbs such as "will," "should," "would" and "could" are intended to identify such forward-looking statements. These statements are not historical facts, but instead represent Bank of America Corporation and its subsidiaries' (the Corporation) current expectations, intentions or forecasts of future events, circumstances or results. These statements are not guarantees of future results or performance and involve certain risks, uncertainties and assumptions that are difficult to predict and often are beyond the Corporation's control. Actual outcomes and results may differ materially from those expressed in, or implied by, our forward-looking statements. You should not place undue reliance on any forward-looking statement and should consider all uncertainties and risks discussed in this report, including under Item 1A. "Risk Factors," as well as those discussed under Item 1A. "Risk Factors" of the Corporation's 2007 Annual Report on Form 10-K and in any of the Corporation's other subsequent SEC filings. Forward-looking statements speak only as of the date they are made, and the Corporation undertakes no obligation to update any forward-looking statement to reflect the impact of circumstances or events that arise after the date the forward-looking statement was made.

In addition to the risk factors discussed under Item 1A. "Risk Factors" in this report and Item 1A. "Risk Factors" of the Corporation's 2007 Annual Report on Form 10-K, other possible events or factors that could cause results or performance to differ materially from those expressed in our forward-looking statements include the following: negative economic conditions that adversely affect the general economy, housing prices, the job market, consumer confidence and spending habits which may affect, among other things, the level of nonperforming assets, charge-offs and provision expense; changes in interest rates and market liquidity which may reduce interest margins, impact funding sources and affect the ability to originate and distribute financial products in the primary and secondary markets; changes in foreign exchange rates; adverse movements and volatility in debt and equity capital markets; changes in market rates and prices which may adversely impact the value of financial products including securities, loans, deposits, debt and derivative financial instruments, and other similar financial instruments; estimates of fair value of certain of the Corporation's assets and liabilities, which could change in value significantly from period to period; legislative and regulatory actions in the United States and internationally which may adversely affect the Corporation's businesses and economic conditions as a whole; liabilities resulting from litigation and regulatory investigations, including costs, expenses, settlements and judgments; changes in domestic or foreign tax laws, rules and regulations as well as court, Internal Revenue Service or other governmental agencies' interpretations thereof; various monetary and fiscal policies and regulations, including those determined by the Board of Governors of the Federal

Reserve System, the Office of the Comptroller of Currency, the Federal Deposit Insurance Corporation, state regulators and the Financial Services Authority; changes in accounting standards, rules and interpretations; increased competition with other large and well-capitalized banks and financial institutions; the Corporation's ability to grow its core businesses; the Corporation's ability to develop and introduce new banking-related products, services and enhancements, and gain market acceptance of such products; mergers and acquisitions and their integration into the Corporation; decisions to downsize, sell or close units or otherwise change the business mix of the Corporation; and management's ability to identify and manage these and other risks.

The Corporation, headquartered in Charlotte, North Carolina, operates in 32 states, the District of Columbia and more than 30 foreign countries. The Corporation provides a diversified range of banking and nonbanking financial services and products domestically and internationally through three business segments: Global Consumer and Small Business Banking (GCSBB), Global Corporate and Investment Banking (GCIB), and Global Wealth and Investment Management (GWIM).

At September 30, 2008, the Corporation had $1.8 trillion in assets and approximately 247,000 full-time equivalent employees. Notes to Consolidated Financial Statements referred to in the MD&A are incorporated by reference into the MD&A. Certain prior period amounts have been reclassified to conform to current period presentation.

Table of Contents
2008 Economic Environment

During the third quarter, market and economic conditions were severely impacted where credit conditions rapidly deteriorated and financial markets experienced widespread illiquidity and elevated levels of volatility. Concerns about future economic growth, oil prices, lower consumer confidence, rapid contraction of credit availability and lower corporate earnings continued to challenge the economy. The rate of unemployment continued to increase, reaching its highest level in nearly five years. Mortgage, corporate and the related counterparty credit spreads widened and heightened concerns about the impact of monoline insurers (monolines), auction rate securities (ARS), and structured investment vehicles (SIVs) adversely impacted the financial markets. As a result of these unparalleled market conditions, federal government agencies including the U.S. Treasury Department (U.S. Treasury) and the Federal Reserve Board initiated several actions which changed the landscape of the U.S. financial services industry. For more information related to these initiatives, see the Regulatory Initiatives discussion below.

The deteriorating economy continued to negatively impact the credit quality of our loan portfolios with more rapid deterioration occurring in the latter part of the most recent quarter. The stress consumers experienced from depreciating home prices, rising unemployment and tighter credit conditions resulted in a higher level of bankruptcy filings during the quarter as well as higher levels of delinquencies and losses in our consumer and small business portfolios. Housing value declines, a slowdown in consumer spending and the turmoil in the global financial markets also impacted our commercial portfolios where we experienced higher levels of losses, particularly in the homebuilder sector of our commercial real estate portfolio. Commercial criticized utilized exposures have also increased due to broader-based economic pressures. During the first nine months of 2008, we increased the allowance for credit losses across most portfolios. For more information on credit quality, see the Credit Risk Management discussion beginning on page 123.

The market dislocations continued to significantly impact our results. We have incurred additional losses on CDOs and related subprime exposure and continue to reduce our exposure to these vehicles. Further, we have also incurred losses associated with investments in certain equity securities (e.g., Fannie Mae and Freddie Mac) and have incurred estimated losses on our commitment to buy back ARS from our clients as discussed in Recent Events below. For more information on CDOs, the related ongoing exposure and the impacts of the continuing market dislocations (e.g., leveraged finance and CMBS writedowns), see the Capital Markets and Advisory Services (CMAS) discussion beginning on page 91.

The market dislocations have continued to impact certain SIVs and have recently begun to impact senior debt issued by financial services companies. During the first nine months of 2008, we provided additional support to certain cash funds managed within GWIM by utilizing existing capital commitments and purchasing certain investments from these funds. Further, one of the SIV investments that we purchased from these funds was restructured resulting in additional losses. For more information on our cash fund support, see the GWIM discussion beginning on page 99.

Market conditions also impacted the ratings of certain monolines, which has affected the pricing of certain municipal securities and the liquidity of the short-term public finance markets. We have direct and indirect exposure to monolines and, in certain situations, recognized losses related to some of these exposures during the first nine months of 2008. For more information related to our monoline exposure, see the Industry Concentrations discussion on page 146.

The above conditions, together with deterioration in the overall economy, will continue to affect these and other global markets in which we do business and will adversely impact our results throughout the remainder of 2008 and into 2009. The degree of the impact is dependent upon the duration and severity of such conditions.

Regulatory Initiatives

On October 3, 2008, the President signed into law the Emergency Economic Stabilization Act of 2008 (EESA). Pursuant to the EESA, the U.S. Treasury has authority to, among other things, invest in financial institutions and purchase mortgages, mortgage-backed securities and certain other financial instruments from financial institutions, in an aggregate amount up to $700 billion, for the purpose of stabilizing and providing liquidity to the U.S. financial markets.

On October 14, 2008, in connection with the Troubled Asset Relief Program (TARP) Capital Purchase Program, established as part of the EESA, the U.S. Treasury announced a plan to invest up to $250 billion in certain eligible financial institutions in the form of non-voting, senior preferred stock initially paying quarterly dividends at a five percent annual

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Table of Contents

rate. When the U.S. Treasury makes such preferred investments in any company, it will also receive 10-year warrants to acquire common shares having an aggregate market price of 15 percent of the amount of the senior preferred investment. In connection with the U.S. Treasury's announcement, we were identified as one of the nine financial institutions to participate in the first $125 billion of U.S. Treasury investments. As a result, we issued to the U.S. Treasury 600 thousand shares of Bank of America Corporation Fixed Rate Cumulative Perpetual Preferred Stock, Series N (Series N Preferred Stock) with a par value of $0.01 per share for $15.0 billion. The Series N Preferred Stock initially pays quarterly dividends at a five percent annual rate that increases to nine percent after five years. The Series N Preferred Stock has a call feature after three years. In connection with this investment, we also issued to the U.S. Treasury warrants to purchase approximately 73.1 million shares of Bank of America Corporation common stock at an exercise price of $30.79 per share.

In connection with the sale of the Series N Preferred Stock, Merrill Lynch & Co., Inc. (Merrill Lynch) entered into an agreement with the U.S. Treasury which allows Merrill Lynch to sell preferred stock and 10-year warrants to the U.S. Treasury for a purchase price of $10.0 billion prior to January 31, 2009 under certain circumstances. The U.S. Treasury has agreed with the Corporation that if the closing of the Merrill Lynch acquisition occurs prior to any such sale of preferred stock by Merrill Lynch, the U.S. Treasury will purchase, and the Corporation will issue, 400 thousand additional shares of Series N Preferred Stock (or a substantially similar series) and warrants to purchase approximately 48.7 million additional shares of common stock at an exercise price of $30.79, for an aggregate purchase price of $10.0 billion.

Under the TARP Capital Purchase Program, dividend payments on, and repurchases of, our outstanding preferred and common stock are subject to certain restrictions. For more information on these restrictions, see Note 19 - Subsequent Events to the Consolidated Financial Statements.

As part of the regulatory initiatives, the FDIC implemented the Temporary Liquidity Guarantee Program (TLGP) to strengthen confidence and encourage liquidity in the banking system. The TLGP is comprised of the Debt Guarantee Program (DGP) and the Transaction Account Guarantee Program (TAGP). The DGP will guarantee all newly issued senior unsecured debt (e.g., promissory notes, unsubordinated unsecured notes and commercial paper) up to prescribed limits issued by participating entities beginning on October 14, 2008 and continuing through June 30, 2009. For eligible debt issued by that date, the FDIC will provide the guarantee coverage until the earlier of the maturity date of the debt or June 30, 2012. The TAGP will offer full guarantee for noninterest-bearing deposit accounts held at FDIC-insured depository institutions. The unlimited deposit coverage will be voluntary for eligible institutions and would be in addition to the $250,000 FDIC deposit insurance per account that was included as part of the EESA. The TAGP coverage became effective on October 14, 2008 and will continue for participating institutions until December 31, 2009.

Initially, these programs were provided at no cost for the first 30 days. On November 3, 2008, the FDIC extended the opt-out period to December 5, 2008 to provide eligible institutions additional time to consider the terms before making a final decision regarding participation in the program. An entity that chooses not to opt out of either or both programs will become a participating entity and will be assessed fees for participation. Participants in the DGP will be charged an annualized fee equal to 75 basis points (bps) multiplied by the debt issued, and calculated for the maturity period of that debt, or through June 30, 2012, whichever is earlier. Any eligible entity that has not chosen to opt out of the TAGP will be assessed, on a quarterly basis, an annualized 10 bps fee on balances in noninterest-bearing transaction accounts that exceed the existing deposit insurance limit of $250,000. Details of these programs are being finalized by regulators. We have agreed in principle to participate in these programs.

In addition to the TLGP, in September 2008, the U.S. Treasury implemented the Temporary Guarantee Program for Money Market Funds. This is a voluntary and temporary program that is in effect through December 18, 2008 with the possibility of being extended. The program provides for a guarantee with respect to a fixed number of shares held by certain shareholders as of September 19, 2008, to receive $1.00 per share in the event that a participating fund no longer has a $1.00 per share net asset value and liquidates. With respect to such shares covered by the program, the guarantee payment would be equal to any shortfall between the amount received by a shareholder in a liquidation and $1.00 per share. The eligible money market mutual funds pay a fee to the U.S. Treasury to participate in the program. Several money market funds managed within GWIM currently participate in the program.

In September and October 2008, the Federal Reserve Board announced the creation of the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), the Commercial Paper Funding Facility (CPFF) as well as the Money Market Investor Funding Facility (MMIFF). These facilities were created to provide liquidity to the U.S. short-term debt markets in an effort to increase the availability of credit. Under the AMLF, nonrecourse loans are provided to U.S. financial institutions for the purchase of U.S. dollar-denominated high-quality asset-backed commercial paper from money market mutual funds under certain conditions. The program is intended to assist money market funds that hold such paper in meeting demands for redemptions by investors and to foster liquidity in the asset-backed commercial paper market and money markets more generally. Financial institutions will bear no credit risk associated with commercial paper purchased under the AMLF. Under the CPFF, registered issuers will be allowed to sell commercial paper through a

Table of Contents

primary dealer to the CPFF subject to certain fees. Pricing will be based on whether the commercial paper is secured or unsecured. In addition, there are issuer-based limits on the amount of commercial paper the facility will hold. Upon implementation of the MMIFF, senior secured funding will be provided to a series of special purpose vehicles to finance the purchase of U.S. dollar-denominated certificates of deposits and commercial paper with a remaining maturity of 90 days or less issued by highly rated financial institutions and from qualifying investors including U.S. money market mutual funds. We have participated in some of the above programs.

In July 2008, the President signed into law the Housing and Economic Recovery Act of 2008. This Act has several provisions including the establishment of a voluntary program that permits the Federal Housing Administration (FHA) to refinance eligible mortgages for certain qualified borrowers. Some of this Act's other provisions include changes to the FHA program, increases in the limits on the principal balances of mortgage loans that the FHA and government-sponsored enterprises (GSEs) can purchase, creating a new regulator for the GSEs, and establishing a registration system for loan originators.

In May 2008, federal bank regulators in the U.S. proposed amendments to the rules regarding Unfair and Deceptive Acts or Practices (UDAP) and Truth in Lending that would restrict certain credit and charge card practices and require expanded disclosures to consumers. Similar legislative initiatives have been proposed. The proposed regulatory amendments include, among other matters, rules relating to the imposition by card issuers of interest rate increases on outstanding balances and the allocation of payments in respect of outstanding balances with different interest rates. If new regulations are adopted as proposed, we would likely make significant changes to our card practices. Also in the May 2008 proposal, federal bank regulators proposed new regulations under the same UDAP authority and under the Truth in Savings Act that would require banks to offer consumer deposit customers the opportunity to opt out of overdraft services and fees. If the new regulations are adopted as proposed, we would need to make significant changes in the manner in which we process transactions that affect consumer deposit accounts.

We are continuing to evaluate these proposals, our participation in the above programs and their impact on our financial condition and results of operations.

Recent Events

In October 2008, prior to the U.S. Treasury's announcement of the TARP Capital Purchase Program discussed above, we issued 455 million shares of common stock at $22.00 per share resulting in proceeds of $9.8 billion, net of underwriting expenses.

In October 2008, the Board of Directors (the Board) declared a regular quarterly cash dividend on common stock of $0.32 per share, payable on December 26, 2008 to common shareholders of record on December 5, 2008, as compared to the quarterly cash dividend on common stock of $0.64 per share paid on September 26, 2008 to common shareholders of record on September 5, 2008. The 50 percent reduction in our regular quarterly cash dividend on common stock was a result of our earnings. In addition in October 2008, we declared aggregate dividends on preferred stock of $297 million, and in the third quarter of 2008 declared aggregate dividends on preferred stock of $473 million. For further discussion on our liquidity and capital, see Liquidity Risk and Capital Management beginning on page 116.

Also in October 2008, in connection with the Housing and Economic Recovery Act of 2008, we announced the creation of a home retention program that was developed in conjunction with several state attorneys general that will systematically modify troubled mortgages with up to $8.4 billion in interest rate and principal reductions for up to 400,000 Countrywide Financial Corporation (Countrywide) customers. This program is eligible to those borrowers who financed their primary residence with subprime or pay option adjustable rate mortgages serviced by Countrywide and originated prior to December 31, 2007. We hold approximately 12 percent of the eligible loans for investment while the remaining 88 percent are loans that we service but do not own. The program is a proactive loan modification process to provide relief to eligible borrowers who are seriously delinquent or are likely to become seriously delinquent as a result of loan features, such as rate resets or payment recasts.

Modification options, among others, include FHA refinancing under the Housing and Economic Recovery Act of 2008; interest rate reductions, which may be granted automatically; and principal reductions on certain pay option adjustable rate mortgages. Under this program, eligible borrowers will not be charged loan modification fees, and prepayment penalties will be waived for qualifying subprime and pay option adjustable rate mortgages Countrywide or its affiliates own. In addition, borrowers in participating states will have access to several programs to provide further financial relief. These foreclosure prevention efforts will reduce foreclosures and the related losses providing a solution for customers and protecting investors. This program is in line with the Corporation's original expectations upon acquisition and is not expected to impact the Corporation's purchase accounting adjustments.

Table of Contents

In September 2008, we announced an agreement to acquire Merrill Lynch in an all-stock transaction. The transaction has been approved by the board of directors of each company. Merrill Lynch common shareholders would receive 0.8595 of a share of Bank of America Corporation common stock in exchange for one share of Merrill Lynch common stock. In addition, Merrill Lynch non-convertible preferred shareholders would receive Bank of America Corporation preferred stock having substantially identical terms. Merrill Lynch convertible preferred stock will remain outstanding and will thereafter be convertible into Bank of America common stock at an equivalent exchange ratio. The acquisition would add Merrill Lynch's more than 16,000 financial advisors and its interest in BlackRock, Inc., a publicly traded investment management company. In addition, the acquisition is expected to increase our underwriting capabilities for debt and equity offerings, as well as our ability to advise on global mergers and acquisitions. The completion of this transaction is subject to closing conditions, and shareholder and regulatory approvals, and is expected to close on or around December 31, 2008.

In September 2008, we provided a $7.5 billion bilateral secured credit facility to Merrill Lynch, which is collateralized by a variety of assets including corporate and commercial real estate loans. The facility matures on the earlier of March 26, 2009 or the completion or termination date of the pending acquisition of Merrill Lynch. Based on collateral delivered as of September 30, 2008, $3.2 billion was available under the facility of which $3.0 billion was outstanding. In October 2008, we provided a $10.0 billion committed unsecured bank revolving credit facility to Merrill Lynch with borrowings guaranteed by the FDIC under the TLGP. This facility will be available to Merrill Lynch until January 30, 2009 but may expire at an earlier date if the pending acquisition of Merrill Lynch is terminated or consummated prior to January 30, 2009 or if Merrill Lynch elects to participate in the TARP Capital Purchase Program.

In September 2008, we announced an agreement in principle with the Massachusetts Securities Division under which we will offer to purchase at par ARS held by certain customers. The offer will cover approximately $4.5 billion in ARS held by an estimated 5,600 of our customers. Further in October 2008, we announced other agreements in principle with the SEC, the Office of the New York State Attorney General (NYAG), and the North American Securities Administrators Association. These agreements are substantially similar except that the agreement with the NYAG requires the payment of a penalty. During the third quarter, we provided for estimated losses on our commitment to buy back ARS from our clients of $313 million in other income and recorded a penalty of $50 million in other general operating expense.

On July 1, 2008, the Corporation acquired Countrywide through its merger with a subsidiary of the Corporation. Under the terms of the agreement, Countrywide shareholders received 0.1822 of a share of Bank of America Corporation common stock in exchange for one share of Countrywide common stock. The acquisition of Countrywide significantly improved our mortgage originating and servicing capabilities while making us a leading mortgage originator and servicer. For more information related to our Countrywide acquisition, see Note 2 - Merger and Restructuring Activity to the Consolidated Financial Statements.

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