

May 2011



Bank of America Credit Summary Report

Ratings

Bank of America Corp.
Long Term
Short Term
Outlook

S&P

A
A-1
Negative

Moody's

A2
P-1
Negative

Fitch

A+
F-1+
Watch Negative

Trend Rating: SV3

Headquartered in Charlotte, N.C., Bank of America (BAC) is the largest U.S. bank as measured by assets totaling \$2.3 trillion as of December 31, 2010. The banking franchise has top market positions in deposits, credit cards, mortgage lending and servicing and small and middle market business lending. Serving approximately 80% of the U.S. population, the bank operates in all states with 5,900 banking centers and leading online and mobile banking platforms. Thanks largely to its 2009 acquisition of Merrill Lynch, BAC is also one of the world's leading wealth managers with more than \$2.2 trillion in client assets. BAC also has a significant global presence in corporate lending, treasury services and investment banking. Senior management sees the franchise as complete and foresees no future acquisitions. The bank has refined its strategy to build a fortress balance sheet by shedding non-core assets and focusing more on customer-centric businesses. The bank provides a diversified range of services and products through its six business segments: Home Loans & Insurance, Global Card Services, Global Commercial Banking, Deposits, Global Wealth & Investment Management and Global Banking & Markets.

The bank's underlying fundamentals remain strong enhanced by the scale, diversity and earnings power of its businesses. Nonetheless, in 2010, BAC was burdened by a number of issues concerning the mortgage market including foreclosure moratoriums and mortgage repurchase demands, the latter being the most significant. While BAC's peers faced similar issues, given its position as the largest mortgage servicer and MBS originator, BAC has been most affected. Additionally, the bank incurred sizeable goodwill impairment charges and remains particularly exposed to the potentially adverse consequences of regulatory changes for banks.

Mortgage repurchase claims from GSE-wrapped as well as non-agency issued mortgage-backed securities increased significantly over the past year. As a result, the associated provision expense increased from \$1.9b to \$6.8b with losses for 2010 of \$4.8b (\$1.3b in 2009) and reserves of \$5.4b (\$3.5b). During 4Q10, BAC reached agreements with Fannie Mae and Freddie Mac, paying \$2.8b to resolve repurchase claims associated with residential mortgage loans sold by the legacy Countrywide. Subsequently, the bank estimated that the outstanding pipeline for all GSE claims was reduced from \$6.8b to \$2.7b. Still, overall claims at year-end remained elevated at \$10.7b (\$7.6b in 2009) as claims from bond insurers rose 12% to \$4.8b and private-label claims rose almost 70% to \$3.1b. The bank's experience with non-agency issues remains limited, but further related claims are expected and the bank estimates a possible loss range of \$7b - \$10b over existing accruals. As a result of the increase in the reps and warranties provision as well as a \$2b goodwill impairment charge, the Home Loans and Insurance segment (recently separated into legacy asset servicing and home loans and insurance) incurred a higher net loss in 2010 compared to the prior year. Besides the higher provision, production volume was lower driving mortgage banking income lower. At the same time expenses were higher partially due to increased litigation expenses and an increase in default-related servicing expense, related to a nationwide freeze on foreclosure sales to review procedures in October 2010, amid reports of forged documents, faulty notarizations and 'robo-signing.' After implementing enhancements, the bank resumed foreclosures in the judicial states (states where a court order to foreclose is needed). During 1Q11, the bank continued to provision for reps and warranties claims with \$500 million related to the GSEs due to house price index

deterioration and higher estimated repurchase rates, and \$500 million related to a loss-sharing reinsurance agreement with Assured Guaranty.

The Global Card Services business also experienced a higher y/o/y net loss driven by a \$10.4b goodwill impairment charge relating to the Durbin Amendment (effective July 2011), which will adversely impact the debit card business. Revenue growth was constrained by lower loans as well as by implementation of the CARD Act, which resulted in lower interest and fee income. Positively, provisions were much improved due to lower delinquencies thanks to an improved economic environment, which led to reserve releases.

All other segments were profitable albeit at lower levels than the previous year, the notable exception being the Global Commercial Banking segment (GCB), which experienced a return to profitability following a prior year loss. With a large customer base and several product offerings including lending and cash management, GCB recorded income of \$3.2b on revenue of \$10.9b. The Deposits segment suffered a 48% decline in income driven by higher expenses and the impact of Reg. E and overdraft policy changes, which reduced service charges by \$1.7b, with an incremental reduction of \$1.1b expected in 2011, net of mitigating action. Global Wealth & Investment Management had AUM of \$644b and total client assets of \$2.2tr as of year-end. Income in this segment declined 22% to \$1.3b mostly due to higher operating expenses partially offset by lower credit costs. With income of \$6.3b, Global Banking & Markets has been a key contributor to earnings as more credit-sensitive businesses have been saddled with high credit costs. Still, income was pressured by lower sales and trading revenue and the absence of a large gain in the prior year related to the merchant processing joint venture.

As noted, 2010 was a challenging year for BAC, reporting a net loss of \$2.2b compared to income of \$6.3b in 2009. Excluding the \$12.4b of goodwill impairment charges, net income was \$10.2b for 2010. Improving credit trends across many businesses enabled lower provisions of \$28.4b (\$48.6b in 2009) and a \$5.9b reserve release. Revenue was down 8% driven by the \$6.8b in reps and warranties charges, lower equity investment gains, lower gains on the sale of debt securities and reduced trading profits and service charges. Core expenses were up 4% due to an increase in personnel costs and litigation expenses. The bank's efficiency ratio at 75% was the highest among large bank peers. In 1Q11, the bank launched an efficiency initiative to grow earnings through expense reduction and expects to see a benefit in 2H12.

Overall, the credit profile is improving with declining credit costs, decreasing nonperforming loans and improving early stage delinquencies. Still, credit quality is problematic for the bank as evidenced by the still elevated level of provisions and a NPA to loans ratio of 3.47% (compared to a peer average of 3.38%). Net charge-offs were relatively flat at 3.6% with the \$114b credit card book accounting for the bulk of the losses. Credit card losses grew \$6.5b y/o/y due to the adoption of the new consolidation guidance in January 2010. Net charge-offs in the home equity book were 4.6% with reserves at a modest 9.4%. Exposure to second lien loans is sizeable at \$100.5b, 36% of which have LTVs greater than 100%. However, even if all high LTV loans were written off, regulatory capital ratios would remain above thresholds. Still, we remain wary of this sizeable exposure, which could potentially be a further drag on earnings. Total reserve coverage was

Bank of America

ample at 4.45% of loans and 128% of nonperformers. Capital ratios were strengthened mainly due to an \$87b reduction in risk-weighted assets. The Tier-1 capital ratio and the Tier-1 common capital ratio increased 84bps and 79bps to 11.24% and 8.6%, respectively, providing comfortable cushions above requirements. BAC has roughly \$21b of TruPS in its Tier 1 capital, which will be phased out over three years in accordance with new rules to be implemented in 2013. Management reiterated that its Tier 1 common ratio will be at or about 8% by 2012, above the 7% minimum requirement. Of the large banks, BAC is the only bank not reinstating a dividend as the request to do so was denied by regulators in March 2011. The bank had requested a modest increase in 2H11 and will re-submit a revised plan closer to that time.

With the benefit of strong deposit franchises within its diverse businesses, BAC's funding was strong with a loan-to-deposit ratio of 93% at year-end. The bank stated that it is on track to meet its goal of a 15%-20% reduction in long-term debt by the end of 2011 and \$150b-\$200b by 2013, having reduced annual debt by more than \$70b (adjusted for FAS166/167). The bank's liquidity position was further enhanced by \$336b of excess liquidity, which comprises mostly

government securities, and holding company time-to-required funding of 24 months.

In 1Q11, BAC announced some senior management changes and additions. As senior management expertise and longevity are important to a company's reputation and success, we hope to see stability in the CFO position, which has seen high turnover for the past few years. This also comes at a time when the bank is managing through various challenges while further strengthening its balance sheet and building capital.

On January 26, 2011, Fitch upgraded BAC's unsupported ratings thanks to improving underlying trends and clarity on its reps and warranties issue. The bank's long-term IDR rating (or supported rating) is now 2-notches above its unsupported rating while the short-term rating is 1-notch above. All supported ratings remain on watch negative pending final resolution of the Dodd-Frank reform. Both S&P and Moody's maintain negative outlooks, with two-notches of uplift at S&P and five and four notches of uplift at the bank and holdco, respectively, at Moody's.

Strengths:

- Established banking franchise with solid market positions across several products and geographies
- Strong earnings generation capacity
- Strong financial profile enhanced by sound funding and liquidity
- Systemically important bank

Weaknesses:

- Continued mortgage market-related issues
- High, although declining, credit costs
- Earnings pressure from legislative and regulatory changes

Key Statistics – Bank of America

| (\$ millions) | 2010 | 2009 | 2008 | 2007 | 2006 | CAGR/Avg |
|-------------------------|---------|---------|---------|---------|---------|----------|
| Loans | 940,440 | 900,128 | 931,446 | 876,344 | 706,490 | 7.4% |
| Assets (\$b) | 2,265 | 2,230 | 1,818 | 1,716 | 1,460 | 11.6% |
| Revenue | 110,220 | 119,643 | 72,782 | 66,833 | 72,776 | 10.9% |
| Net Income | (2,238) | 6,276 | 4,008 | 14,982 | 21,133 | (42.9%) |
| Return on Common Equity | n/m | 2.7% | 1.8% | 11.1% | 16.3% | n/m |
| Return on Assets | n/m | 0.26% | 0.22% | 0.94% | 1.44% | n/m |
| Tier 1 Capital Ratio | 11.24% | 10.40% | 9.15% | 6.87% | 8.64% | 9.26% |
| Total Capital Ratio | 8.60% | 7.81% | 4.80% | 4.93% | 6.82% | 6.59% |

Sources: Company reports and SEC filings.

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