WELLS FARGO & COMPANY/MN
Form 10-Q
August 04, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

Commission file number 001-2979

WELLS FARGO & COMPANY
(Exact name of registrant as specified in its charter)

Delaware	No. 41-0449260
(State of incorporation)	(I.R.S. Employer Identification No.)

420 Montgomery Street, San Francisco, California 94163
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: 1-866-249-3302

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	þ	Accelerated filer o
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

	Shares Outstanding July 26, 2017
Common stock, $1-2/3 par value	4,963,944,641

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PART I - FINANCIAL INFORMATION

FINANCIAL REVIEW
Summary Financial Data

($ in millions, except per share amounts)	Quarter ended Jun 30, 2017	Mar 31, 2017	Jun 30, 2016	% Change Jun 30, 2017 from Mar 31, 2017	Jun 30, 2016	Six months ended Jun 30, 2017	Jun 30, 2016	% Change
For the Period								
Wells Fargo net income	$5,810	5,457	5,558	6 %	5	$11,267	11,020	2 %
Wells Fargo net income applicable to common stock	5,404	5,056	5,173	7	4	10,460	10,258	2
Diluted earnings per common share	1.07	1.00	1.01	7	6	2.07	2.00	4
Profitability ratios (annualized):								
Wells Fargo net income to average assets (ROA)	1.21 %	1.15	1.20	5	1	1.18 %	1.20	(2)
Wells Fargo net income applicable to common stock to average Wells Fargo common stockholders' equity (ROE)	11.95	11.54	11.70	4	2	11.75	11.72	—
Return on average tangible common equity (ROTCE) (1)	14.26	13.85	14.15	3	1	14.06	14.15	(1)
Efficiency ratio (2)	61.1	62.7	58.1	(3)	5	61.9	58.4	6
Total revenue	$22,169	22,002	22,162	1	—	$44,171	44,357	—
Pre-tax pre-provision profit (PTPP) (3)	8,628	8,210	9,296	5	(7)	16,838	18,463	(9)
Dividends declared per common share	0.380	0.380	0.380	—	—	0.760	0.755	1
Average common shares outstanding	4,989.9	5,008.6	5,066.9	—	(2)	4,999.2	5,071.3	(1)
Diluted average common shares outstanding	5,037.7	5,070.4	5,118.1	(1)	(2)	5,054.8	5,129.8	(1)
Average loans	$956,879	963,645	950,751	(1)	1	$960,243	938,986	2
Average assets	1,927,079	1,931,041	1,862,084	—	3	1,929,049	1,840,980	5
Average total deposits	1,301,195	1,299,191	1,236,658	—	5	1,300,198	1,228,044	6
Average consumer and small business banking deposits (4)	760,149	758,754	726,359	—	5	759,455	720,598	5
Net interest margin	2.90 %	2.87	2.86	1	1	2.89 %	2.88	—
At Period End								
Investment securities	$409,594	407,560	353,426	—	16	$409,594	353,426	16
Loans	957,423	958,405	957,157	—	—	957,423	957,157	—
	11,073	11,168	11,664	(1)	(5)	11,073	11,664	(5)

Allowance for loan losses								
Goodwill	26,573	26,666	26,963	—	(1)	26,573	26,963	(1)
Assets	1,930,871	1,951,564	1,889,235	(1)	2	1,930,871	1,889,235	2
Deposits	1,305,830	1,325,444	1,245,473	(1)	5	1,305,830	1,245,473	5
Common stockholders' equity	181,428	178,388	178,633	2	2	181,428	178,633	2
Wells Fargo stockholders' equity	205,230	201,500	201,745	2	2	205,230	201,745	2
Total equity	206,145	202,489	202,661	2	2	206,145	202,661	2
Tangible common equity (1)	152,064	148,850	148,110	2	3	152,064	148,110	3
Capital ratios (5)(6):								
Total equity to assets	10.68 %	10.38	10.73	3	—	10.68 %	10.73	—
Risk-based capital:								
Common Equity Tier 1	11.87	11.52	10.82	3	10	11.87	10.82	10
Tier 1 capital	13.68	13.27	12.50	3	9	13.68	12.50	9
Total capital	16.91	16.41	15.14	3	12	16.91	15.14	12
Tier 1 leverage	9.28	9.07	9.25	2	—	9.28	9.25	—
Common shares outstanding	4,966.8	4,996.7	5,048.5	(1)	(2)	4,966.8	5,048.5	(2)
Book value per common share (7)	$36.53	35.70	35.38	2	3	$36.53	35.38	3
Tangible book value per common share (1) (7)	30.62	29.79	29.34	3	4	30.62	29.34	4
Common stock price:								
High	56.60	59.99	51.41	(6)	10	59.99	53.27	13
Low	50.84	53.35	44.50	(5)	14	50.84	44.50	14
Period end	55.41	55.66	47.33	—	17	55.41	47.33	17
Team members (active, full-time equivalent)	270,600	272,800	267,900	(1)	1	270,600	267,900	1

(1) Tangible common equity is a non-GAAP financial measure and represents total equity less preferred equity, noncontrolling interests, and goodwill and certain identifiable intangible assets (including goodwill and intangible assets associated with certain of our nonmarketable equity investments and held-for-sale assets, but excluding mortgage servicing rights), net of applicable deferred taxes. The methodology of determining tangible common equity may differ among companies. Management believes that return on average tangible common equity and tangible book value per common share, which utilize tangible common equity, are useful financial measures because they enable investors and others to assess the Company's use of equity. For additional information, including a corresponding reconciliation to GAAP financial measures, see the “Capital Management – Tangible Common Equity” section in this Report.

(2) The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income).

(3) Pre-tax pre-provision profit (PTPP) is total revenue less noninterest expense. Management believes that PTPP is a useful financial measure because it enables investors and others to assess the Company's ability to generate capital to cover credit losses through a credit cycle.

(4) Consumer and small business banking deposits are total deposits excluding mortgage escrow and wholesale deposits.

(5) The risk-based capital ratios were calculated under the lower of Standardized or Advanced Approach determined pursuant to Basel III with Transition Requirements. Accordingly, the total capital ratio was calculated under the Advanced Approach and the other ratios were calculated under the Standardized Approach, for each of the periods.

(6) See the “Capital Management” section and Note 19 (Regulatory and Agency Capital Requirements) to Financial Statements in this Report for additional information.

(7) Book value per common share is common stockholders' equity divided by common shares outstanding. Tangible book value per common share is tangible common equity divided by common shares outstanding.

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Overview (continued)

This Quarterly Report, including the Financial Review and the Financial Statements and related Notes, contains forward-looking statements, which may include forecasts of our financial results and condition, expectations for our operations and business, and our assumptions for those forecasts and expectations. Do not unduly rely on forward-looking statements. Actual results may differ materially from our forward-looking statements due to several factors. Factors that could cause our actual results to differ materially from our forward-looking statements are described in this Report, including in the "Forward-Looking Statements" section, and the "Risk Factors" and "Regulation and Supervision" sections of our Annual Report on Form 10-K for the year ended December 31, 2016 (2016 Form 10-K).

When we refer to "Wells Fargo," "the Company," "we," "our" or "us" in this Report, we mean Wells Fargo & Company and Subsidiaries (consolidated). When we refer to the "Parent," we mean Wells Fargo & Company. See the Glossary of Acronyms for terms used throughout this Report.

Financial Review

Overview

Wells Fargo & Company is a diversified, community-based financial services company with $1.93 trillion in assets. Founded in 1852 and headquartered in San Francisco, we provide banking, insurance, investments, mortgage, and consumer and commercial finance through more than 8,500 locations, 13,000 ATMs, digital (online, mobile and social), and contact centers (phone, email and correspondence), and we have offices in 42 countries and territories to support customers who conduct business in the global economy. With approximately 271,000 active, full-time equivalent team members, we serve one in three households in the United States and ranked No. 25 on Fortune's 2017 rankings of America's largest corporations. We ranked third in assets and second in the market value of our common stock among all U.S. banks at June 30, 2017.

We use our Vision and Values to guide us toward growth and success. Our vision is to satisfy our customers' financial needs, help them succeed financially, be recognized as the premier financial services company in our markets, and be one of America's great companies. We aspire to create deep and enduring relationships with our customers by providing them with an exceptional experience and by understanding their needs and delivering the most relevant products, services, advice, and guidance.

We have five primary values, which are based on our vision and provide the foundation for everything we do. First, we value and support our people as a competitive advantage and strive to attract, develop, retain, and motivate the most talented people we can find. Second, we strive for the highest ethical standards with our team members, our customers, our communities, and our shareholders. Third, with respect to our customers, we strive to base our decisions and actions on what is right for them in everything we do. Fourth, for team members we strive to build and sustain a diverse and inclusive culture – one where they feel valued and respected for who they are as well as for the skills and experiences they bring to our company. Fifth, we also look to each of our team members to be leaders in establishing, sharing, and communicating our vision. In addition to our five primary values, one of our key day-to-day priorities is to make risk management a competitive advantage by working hard to ensure that appropriate controls are in place to reduce risks to our customers, maintain and increase our competitive market position, and protect Wells Fargo's long-term safety, soundness, and reputation.

In keeping with our primary values and risk management priorities, we announced six new long-term goals for the Company in March 2017, which entail becoming the leader in the following areas:

- Customer service and advice – provide best-in-class service and guidance to our customers to help them reach their financial goals.
- Team member engagement – be a company where people matter, teamwork is rewarded, everyone feels respected and empowered to speak up, diversity and inclusion are embraced, and "how" our work gets done is just as important as getting the work done.
-

Innovation – create new kinds of lasting value for our customers and businesses by using innovative technologies and moving quickly to bring about change.
- Risk management – desire to set the global standard in managing all forms of risk.
- Corporate citizenship – make better every community in which we live and do business.
- Shareholder value – earn the confidence of shareholders by maximizing long-term value.

Over the past several months, our Board of Directors (Board) has undertaken a series of significant actions to enhance Board oversight and governance. The actions the Board has taken to date, many of which reflect the feedback we received from our investors and other stakeholders, include separating the roles of Chairman of the Board and Chief Executive Officer, amending Wells Fargo's By-Laws to require that the Chairman be an independent director, adding two new independent directors in February 2017, and amending Board committee charters to enhance oversight of conduct risk. The Board recognizes that there is still work to be done and, in response to feedback received at our annual stockholders meeting in April 2017, the Board is engaging in an ongoing comprehensive review of its structure, composition and practices. This review is expected to result in actions in third quarter 2017, which will be publicly announced at that time. As has been our practice, we will continue our engagement efforts with our investors and other stakeholders.

Sales Practices Matters

As we have previously reported, on September 8, 2016, we announced settlements with the Consumer Financial Protection Bureau (CFPB), the Office of the Comptroller of the Currency (OCC), and the Office of the Los Angeles City Attorney, and entered into consent orders with the CFPB and the OCC, in connection with allegations that some of our retail customers received products and services they did not request. As a result, it remains our top priority to rebuild trust through a comprehensive action plan that includes making things right for our customers, team members, and other stakeholders, and to build a better Company for the future.

The job of rebuilding trust in Wells Fargo is a long-term effort – one requiring our commitment and perseverance. As we move forward, Wells Fargo has a specific action plan in place focused on reaching out to stakeholders who may have been affected by improper retail banking sales practices, including our

communities, our customers, our regulators, our team members, and our investors.

Our priority of rebuilding trust has included the following additional actions, which have been focused on identifying potential financial harm and customer remediation:

Identifying Potential Financial Harm

- In the fall of 2016, the Board and management undertook an enterprise-wide review of sales practices issues. This review is ongoing.
- A third-party consulting firm performed an initial review of accounts opened from May 2011 to mid-2015 to identify financial harm stemming from potentially unauthorized accounts.
- We expanded the time periods of this review to cover the entire consent order period of January 2011 through September 2016, and to perform a voluntary review of accounts from 2009 to 2010. We expect to complete this expanded review process and commence remaining remediation for these additional periods by the end of third quarter 2017.
- As part of this expanded review process, we also expect to complete the review and validation of the number of potentially unauthorized accounts previously identified by the third-party consulting firm, including refinements to the practices and methodologies previously used to determine such number and to remediate sales practices related matters. We expect that our review of the expanded time periods, which adds over three years to the initial review period of approximately four years (May 2011 to mid-2015), and our review and validation efforts for the initial review period, may lead to a significant increase in the identified number of potentially unauthorized accounts. However, we do not expect any incremental customer remediation costs as a result of these efforts to have a significant financial impact on the Company.

Customer Remediation

- We refunded $3.26 million to customers under the stipulated judgment with the Los Angeles City Attorney and under the CFPB and OCC consent orders, covering the period from May 2011 to mid-2015.
- As of May 31, 2017, we had paid $1.8 million in additional payments to customers nationwide through our ongoing complaints process and free mediation services that were put in place in connection with the sales practices matters.
- On July 9, 2017, we announced updates to the settlement agreement for a class-action lawsuit concerning improper retail sales practices. With the court's preliminary approval of the settlement agreement, Wells Fargo and the plaintiffs are preparing to issue notices that will provide information about the process for making claims. We expect this settlement to resolve substantially all claims in other similar pending class actions that allege unauthorized accounts were opened in customers' names or that customers were enrolled in certain products or services without their consent. The settlement class covers the period from May 1, 2002 to April 20, 2017, and includes funds to ensure that each customer who was affected by improper retail sales practices has an opportunity for remediation.
- We are working to complete the requirements of our regulatory consent orders, which include a review by an independent consultant to determine the "root cause" of the sales practices issues and the implementation of an action plan that addresses the findings of the independent review. The independent consultant's report, which is regulatory supervisory information that cannot be publicly disclosed, is expected to be completed in third quarter 2017.

For additional information regarding sales practices matters, including related legal matters, see the "Risk Factors" section in our 2016 Form 10-K and Note 11 (Legal Actions) to Financial Statements in this Report.

Additional Efforts to Rebuild Trust

Our priority of rebuilding trust has also included an effort to identify other areas or instances where customers may have experienced financial harm. We are working with our regulatory agencies in this effort. As part of this effort, we are focused on the following key areas:

- Practices concerning the origination, servicing, and/or collection of indirect consumer auto loans, including related insurance products. For example:
  - The Company recently announced a plan to remediate customers who may have been financially harmed due to issues related to automobile collateral protection insurance (CPI) policies purchased through a third-party vendor on their behalf (based on an understanding by the vendor that the borrowers' insurance had lapsed). The

plan currently consists of approximately $64 million in cash remediation and $16 million in account adjustments. The Company discontinued the CPI placement program in September 2016.

- The Company has identified certain issues related to the unused portion of guaranteed automobile protection waiver or insurance agreements between the dealer and, by assignment, the lender, which may result in refunds to customers in certain states.
- Policies and procedures regarding the circumstances in which the Company required customers to pay fees for the extension of interest rate lock periods for residential mortgages.
- Practices related to certain consumer "add-on" products (e.g., identity theft and debt protection), including those products that are subject to an OCC consent order entered into in May 2015.
- Procedures regarding the freezing (and, in many cases, closing) of consumer deposit accounts after the Company detected suspected fraudulent activity (by third-parties or account holders) that affected those accounts.

For more information, see the "Risk Factors" section in our 2016 Form 10-K and Note 11 (Legal Actions) to Financial Statements in this Report.

This effort to identify similar instances in which customers may have experienced harm is ongoing, and it is possible that we may identify other areas of potential concern.

Financial Performance

Wells Fargo net income was $5.8 billion in second quarter 2017 with diluted earnings per common share (EPS) of $1.07, compared with $5.6 billion and $1.01, respectively, a year ago. We have now generated quarterly earnings of more than $5 billion for 19 consecutive quarters, which reflected the ability of our diversified business model and risk discipline to generate consistent financial performance during a period that included market volatility and economic uncertainty. We remain focused on meeting the financial needs of our customers and on investing in our businesses so we may continue to meet the evolving needs of our customers in the future.

Overview (continued)

Compared with a year ago:

- revenue was $22.2 billion, stable compared with a year ago, with record net interest income in second quarter 2017, up 6% from a year ago;
- average loans of $956.9 billion increased $6.1 billion, or 1%;
- total deposits were $1.3 trillion, up $60.4 billion, or 5%;
- our credit results improved with a net charge-off rate of 0.27% (annualized) of average loans and we had a $100 million release from the allowance for credit losses; and
- we returned $3.4 billion to shareholders through common stock dividends and net share repurchases, which was the eighth consecutive quarter of returning more than $3 billion.

Balance Sheet and Liquidity

Our balance sheet remained strong during second quarter 2017 with high levels of liquidity and capital. Our total assets were $1.93 trillion at June 30, 2017. Investment securities reached $409.6 billion, with approximately $37 billion of gross purchases during second quarter 2017, largely offset by runoff and the sale of approximately $15 billion of lower-yielding short-duration securities. Loans were down $10.2 billion, or 1%, from December 31, 2016, largely due to a decline in junior lien mortgage and automobile loans.

Average deposits in second quarter 2017 reached a record $1.30 trillion, up $64.5 billion, or 5%, from second quarter 2016. Our average deposit cost in second quarter 2017 was 21 basis points, up 10 basis points from a year ago, which reflected an increase in commercial deposit rates. We successfully grew our primary consumer checking customers (i.e., customers who actively use their checking account with transactions such as debit card purchases, online bill payments, and direct deposit) by 0.7% (May 2017 compared with May 2016).

Credit Quality

Solid overall credit results continued in second quarter 2017 as losses remained low and we continued to originate high quality loans, reflecting our long-term risk focus. Net charge-offs were $655 million, or 0.27% (annualized) of average loans, in second quarter 2017, compared with $924 million a year ago (0.39%). The decrease in net charge-offs in second quarter 2017, compared with a year ago, was driven by lower losses in the oil and gas portfolio and increased recoveries in the commercial portfolio. Our total oil and gas loan exposure of $48.3 billion, which includes unfunded commitments and loans outstanding, was down 14% from a year ago.

Our commercial portfolio net charge-offs were $75 million, or 6 basis points of average commercial loans, in second quarter 2017, compared with net charge-offs of $357 million, or 29 basis points, a year ago. Net consumer credit losses increased to 51 basis points of average consumer loans in second quarter 2017 from 49 basis points in second quarter 2016. Our commercial real estate portfolios were in a net recovery position for the 18th consecutive quarter, reflecting our conservative risk discipline and improved market conditions. Losses on our consumer real estate portfolios declined $96 million, or 126%, from a year ago, reflecting the benefit of the continued improvement in the housing market and our continued focus on originating high quality loans. Approximately 76% of the consumer first mortgage portfolio outstanding at June 30, 2017, was originated after 2008, when more stringent underwriting standards were implemented.

The allowance for credit losses as of June 30, 2017, decreased $603 million compared with a year ago and decreased $394 million from December 31, 2016. The allowance coverage for total loans was 1.27% at June 30, 2017, compared with 1.33% a year ago and 1.30% at December 31, 2016. The allowance covered 4.6 times annualized second quarter net charge-offs, compared with 3.4 times a year ago. Future allowance levels will be based on a variety of factors, including loan growth, portfolio performance and general economic conditions. Our provision for loan losses was $555 million in second quarter 2017, down from $1.1 billion a year ago, primarily reflecting improvement in the oil and gas portfolio.

Nonperforming assets decreased $827 million, or 8%, from March 31, 2017, with improvement across our consumer and commercial portfolios and lower foreclosed assets. Nonperforming assets were only 1.03% of total loans, the lowest level since the merger with Wachovia in 2008. Nonaccrual loans decreased $703 million from the prior quarter

partially due to a $321 million decrease in commercial nonaccruals. In addition, foreclosed assets were down $124 million from the prior quarter.

Capital

Our financial performance in second quarter 2017 resulted in strong capital generation, which increased total equity to a record $206.1 billion at June 30, 2017, up $5.6 billion from December 31, 2016. We returned $3.4 billion to shareholders in second quarter 2017 through common stock dividends and net share repurchases and our net payout ratio (which is the ratio of (i) common stock dividends and share repurchases less issuances and stock compensation-related items, divided by (ii) net income applicable to common stock) was 63%, up from 61% in the prior quarter, and within our targeted range of 55-75%. We continued to reduce our common shares outstanding through the repurchase of 43.0 million common shares in the quarter. We also entered into a $1 billion forward repurchase contract with an unrelated third party in July 2017 that is expected to settle in fourth quarter 2017 for approximately 19 million shares. We expect to reduce our common shares outstanding through share repurchases throughout the remainder of 2017.

We believe an important measure of our capital strength is the Common Equity Tier 1 ratio under Basel III, fully phased-in, which was 11.59% at June 30, 2017. Likewise, our other regulatory capital ratios remained strong. We also received a non-objection to our 2017 Capital Plan submission from the Federal Reserve. See the “Capital Management” section in this Report for more information regarding our capital, including the calculation of our regulatory capital amounts.

Earnings Performance

Wells Fargo net income for second quarter 2017 was $5.8 billion ($1.07 diluted earnings per common share), compared with $5.6 billion ($1.01 diluted per share) for second quarter 2016. Net income for the first half of 2017 was $11.3 billion ($2.07), compared with $11.0 billion ($2.00) for the same period a year ago. We generated revenue growth across many of our businesses. Our financial performance in the first half of 2017, compared with the same period a year ago, benefited from a $1.4 billion increase in net interest income and a $1.0 billion decrease in our provision for credit losses, offset by a $1.6 billion decrease in noninterest income and a $1.4 billion increase in noninterest expense. In the first half of 2017, net interest income represented 56% of revenue, compared with 53% for the same period in 2016. Noninterest income was $19.4 billion in the first half of 2017, representing 44% of revenue, compared with $21.0 billion (47%) in the first half of 2016.

Revenue, the sum of net interest income and noninterest income, was $22.2 billion in the second quarter of both 2017 and 2016. Revenue for the first half of 2017 was $44.2 billion, compared with $44.4 billion for the first half of 2016. The decrease in revenue for the first half of 2017, compared with the same period in 2016, was due to a decline in noninterest income, partially offset by an increase in interest income from loans and investment securities.

Net Interest Income

Net interest income is the interest earned on debt securities, loans (including yield-related loan fees) and other interest-earning assets minus the interest paid on deposits, short-term borrowings and long-term debt. The net interest margin is the average yield on earning assets minus the average interest rate paid for deposits and our other sources of funding. Net interest income and the net interest margin are presented on a taxable-equivalent basis in Table 1 to consistently reflect income from taxable and tax-exempt loans and securities based on a 35% federal statutory tax rate.
While the Company believes that it has the ability to increase net interest income over time, net interest income and the net interest margin in any one period can be significantly affected by a variety of factors including the mix and overall size of our earning assets portfolio and the cost of funding those assets. In addition, some variable sources of interest income, such as resolutions from purchased credit-impaired (PCI) loans, loan fees and collection of interest on nonaccrual loans, can vary from period to period. Net interest income and net interest margin growth has been challenged during the prolonged low interest rate environment as higher yielding loans and securities have run off and been replaced with lower yielding assets.

Net interest income on a taxable-equivalent basis was $12.8 billion and $25.4 billion in the second quarter and first half of 2017, respectively, compared with $12.0 billion and $24.0 billion for the same periods a year ago. The net interest margin was 2.90% and 2.89% for the second quarter and first half of 2017, respectively, up from 2.86% and 2.88% for the same periods a year ago. The increase in net interest income in the second quarter and first half of 2017 from the same periods a year ago resulted from an increase in interest income, partially offset by an increase in interest expense on funding sources. The increase in interest income was driven by balance growth in earning assets and the benefit of higher interest rates, offset by lower variable income. Interest expense on funding sources increased in the second quarter and first half of 2017, compared with the same periods a year ago, with a significant portion due to growth and repricing of long-term debt. Deposit interest expense was also higher, predominantly due to an increase in wholesale pricing resulting from higher interest rates.

The increase in net interest margin in the second quarter and first half of 2017, compared with the same periods a year ago, was primarily due to repricing benefits of earning assets from higher interest rates exceeding the repricing costs of deposits and market based funding sources.

Average earning assets increased $82.4 billion and $101.9 billion in the second quarter and first half of 2017, respectively, compared with the same periods a year ago, as average loans increased $6.1 billion in the second quarter and $21.3 billion in the first half of 2017, average investment securities increased $67.5 billion in second quarter 2017 and $68.6 billion in the first half of 2017, and average trading assets increased $16.7 billion in the second quarter and $15.0 billion in the first half of 2017, compared with the same periods a year ago. In addition, average federal funds sold and other short-term investments decreased $12.2 billion and $6.6 billion in the second quarter and first half of 2017, respectively, compared with the same periods a year ago.

Deposits are an important low-cost source of funding and affect both net interest income and the net interest margin. Deposits include noninterest-bearing deposits, interest-bearing checking, market rate and other savings, savings certificates, other time deposits, and deposits in foreign offices. Average deposits of $1.30 trillion in both the second quarter and first half of 2017, increased compared with $1.24 trillion and $1.23 trillion for the same periods a year ago, and represented 136% of average loans in second quarter 2017 (135% in the first half of 2017), compared with 130% in second quarter 2016 (131% in the first half of 2016). Average deposits remained stable at 74% and 73% of average earning assets in the second quarter and first half of 2017, respectively, compared with 73% and 74% for the same periods a year ago.

Table 1: Average Balances, Yields and Rates Paid (Taxable-Equivalent Basis) (1)(2)

	Quarter ended June 30,							
				2017				2016
(in millions)	Average balance	Yields/ rates		Interest income/ expense	Average balance	Yields/ rates		Interest income/ expense
Earning assets								
Federal funds sold, securities purchased under resale agreements and other short-term investments	$281,619	0.99	%	$698	293,783	0.49	%	$359
Trading assets	98,086	2.95		722	81,380	2.86		582
Investment securities (3):								
Available-for-sale securities:								
Securities of U.S. Treasury and federal agencies	18,099	1.53		69	31,525	1.56		123
Securities of U.S. states and political subdivisions	53,492	4.03		540	52,201	4.24		553
Mortgage-backed securities:								
Federal agencies	132,032	2.63		868	92,010	2.53		583
Residential and commercial	12,586	5.55		175	19,571	5.44		266
Total mortgage-backed securities	144,618	2.89		1,043	111,581	3.04		849
Other debt and equity securities	48,962	3.87		472	53,301	3.48		461
Total available-for-sale securities	265,171	3.21		2,124	248,608	3.20		1,986
Held-to-maturity securities:								
Securities of U.S. Treasury and federal agencies	44,701	2.19		244	44,671	2.19		243
Securities of U.S. states and political subdivisions	6,270	5.29		83	2,155	5.41		29
Federal agency and other mortgage-backed securities	83,116	2.44		507	35,057	1.90		166
Other debt securities	2,798	2.34		16	4,077	1.92		20
Total held-to-maturity securities	136,885	2.49		850	85,960	2.14		458
Total investment securities	402,056	2.96		2,974	334,568	2.93		2,444
Mortgages held for sale (4)	19,758	3.94		195	20,140	3.60		181
Loans held for sale (4)	210	6.95		4	239	4.83		3
Loans:								
Commercial:								
Commercial and industrial – U.S.	273,073	3.70		2,521	270,862	3.45		2,328
Commercial and industrial – Non U.S.	56,426	2.86		402	51,201	2.35		300
Real estate mortgage	131,293	3.68		1,206	126,126	3.41		1,069
Real estate construction	25,271	4.10		259	23,115	3.49		200
Lease financing	19,058	4.82		230	18,930	5.12		242
Total commercial	505,121	3.67		4,618	490,234	3.39		4,139
Consumer:								
Real estate 1-4 family first mortgage	275,108	4.08		2,805	275,854	4.01		2,765
Real estate 1-4 family junior lien mortgage	43,602	4.78		521	50,609	4.37		551
Credit card	34,868	12.18		1,059	33,368	11.52		956
Automobile	59,112	5.43		800	61,149	5.66		860
Other revolving credit and installment	39,068	6.13		596	39,537	5.91		581
Total consumer	451,758	5.13		5,781	460,517	4.98		5,713
Total loans (4)	956,879	4.36		10,399	950,751	4.16		9,852
Other	10,713	2.00		54	6,014	2.30		35
Total earning assets	$1,769,321	3.41	%	$15,046	1,686,875	3.20	%	$13,456
Funding sources								
Deposits:								

Interest-bearing checking	$48,465	0.41	%	$50	39,772	0.13	%	$13
Market rate and other savings	683,014	0.13		214	658,944	0.07		110
Savings certificates	22,599	0.30		17	26,246	0.35		23
Other time deposits	57,158	1.43		203	61,170	0.85		129
Deposits in foreign offices	123,684	0.65		199	97,525	0.23		57
Total interest-bearing deposits	934,920	0.29		683	883,657	0.15		332
Short-term borrowings	95,763	0.69		164	111,848	0.28		78
Long-term debt	249,518	2.05		1,278	236,156	1.56		921
Other liabilities	20,981	2.05		108	16,336	2.06		83
Total interest-bearing liabilities	1,301,182	0.69		2,233	1,247,997	0.45		1,414
Portion of noninterest-bearing funding sources	468,139	—		—	438,878			—
Total funding sources	$1,769,321	0.51		2,233	1,686,875	0.34		1,414
Net interest margin and net interest income on a taxable-equivalent basis (5)		2.90	%	$12,813		2.86	%	$12,042
Noninterest-earning assets								
Cash and due from banks	$18,171				18,818			
Goodwill	26,664				27,037			
Other	112,923				129,354			
Total noninterest-earning assets	$157,758				175,209			
Noninterest-bearing funding sources								
Deposits	$366,275				353,001			
Other liabilities	53,654				60,083			
Total equity	205,968				201,003			
Noninterest-bearing funding sources used to fund earning assets	(468,139)				(438,878)			
Net noninterest-bearing funding sources	$157,758				175,209			
Total assets	$1,927,079				1,862,084			

(1) Our average prime rate was 4.05% and 3.50% for the quarters ended June 30, 2017 and 2016, respectively, and 3.92% and 3.50% for the first half of 2017 and 2016, respectively. The average three-month London Interbank Offered Rate (LIBOR) was 1.21% and 0.64% for the quarters ended June 30, 2017 and 2016, respectively, and 1.14% and 0.63% for the first half of 2017 and 2016, respectively.

(2) Yields/rates and amounts include the effects of hedge and risk management activities associated with the respective asset and liability categories.

(3) Yields and rates are based on interest income/expense amounts for the period, annualized based on the accrual basis for the respective accounts. The average balance amounts represent amortized cost for the periods presented.

(4) Nonaccrual loans and related income are included in their respective loan categories.

(5) Includes taxable-equivalent adjustments of $330 million and $309 million for the quarters ended June 30, 2017 and 2016, respectively, and $648 million and $599 million for the first half of 2017 and 2016, respectively, predominantly related to tax-exempt income on certain loans and securities. The federal statutory tax rate utilized was 35% for the periods presented.

	Six months ended June 30,							
				2017				2016
(in millions)	Average balance	Yields/ rates		Interest income/ expense	Average balance	Yields/ rates		Interest income/ expense
Earning assets								
Federal funds sold, securities purchased under resale agreements and other short-term investments	$282,687	0.88	%	$ 1,230	289,240	0.49	%	$ 703
Trading assets	95,937	2.87		1,377	80,922	2.94		1,187
Investment securities (3):								
Available-for-sale securities:								
Securities of U.S. Treasury and federal agencies	21,547	1.53		164	33,000	1.58		259
Securities of U.S. states and political subdivisions	52,873	4.03		1,066	51,357	4.24		1,088
Mortgage-backed securities:								
Federal agencies	144,257	2.61		1,879	94,216	2.67		1,258
Residential and commercial	13,514	5.43		367	20,199	5.32		537
Total mortgage-backed securities	157,771	2.85		2,246	114,415	3.14		1,795
Other debt and equity securities	49,787	3.73		924	53,430	3.34		890
Total available-for-sale securities	281,978	3.13		4,400	252,202	3.20		4,032
Held-to-maturity securities:								
Securities of U.S. Treasury and federal agencies	44,697	2.20		487	44,667	2.19		487
Securities of U.S. states and political subdivisions	6,271	5.30		166	2,155	5.41		58
Federal agency and other mortgage-backed securities	67,538	2.46		831	31,586	2.16		341
Other debt securities	3,062	2.34		35	4,338	1.92		42
Total held-to-maturity securities	121,568	2.51		1,519	82,746	2.25		928
Total investment securities	403,546	2.94		5,919	334,948	2.97		4,960
Mortgages held for sale (4)	19,825	3.82		379	19,005	3.60		342
Loans held for sale (4)	161	6.08		5	260	3.97		5
Loans:								
Commercial:								
Commercial and industrial – U.S.	273,905	3.65		4,957	264,295	3.42		4,505
Commercial and industrial – Non U.S.	55,890	2.80		775	50,354	2.23		558
Real estate mortgage	131,868	3.62		2,370	124,432	3.41		2,109
Real estate construction								