SVB Financial Group's (SIVB) CEO Greg Becker on Q3 2019 Results - Earnings Call Transcript

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SVB Financial Group (NASDAQ:SIVB) Q3 2019 Earnings Conference Call October 24, 2019 6:00 PM ET

Company Participants

Meghan O'Leary – Head-Investor Relations

Greg Becker – President and Chief Executive Officer

Dan Beck – Chief Financial Officer

Mike Descheneaux – President, Silicon Valley Bank

Marc Cadieux – Chief Credit Officer

Conference Call Participants

Ken Zerbe – Morgan Stanley

Aaron Deer – Sandler O'Neill

Steven Alexopoulos – JPMorgan

Ebrahim Poonawala – Bank of America

Jared Shaw – Wells Fargo

Chris McGratty – KBW

Brock Vandervliet – UBS

Gary Tenner – D.A. Davidson

David Chiaverini – Wedbush

Operator

Welcome to the SVB Financial Group Q3 2019 Earnings Call. My name is Adriane, and I will be your operator for today's call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session. [Operator Instructions] Please note this conference call is being recorded.

I'll now turn the call over to Meghan O'Leary, Head of Investor Relations. Meghan O'Leary, you may begin.

Meghan O'Leary

Thank you, Adriane. Hello, everyone. Thanks for joining us. We're sorry to be starting a few minutes late. As some of you may know, the EDGAR system was down this evening when we went to file our press release. And so, we had to make due with that. We have hosted it in the new section of svb.com as well as in the IR section of svb.com. That's the press release, the summary slides and the CEO letter. We will also be issuing it via Newswire, but it's taken them a while to queue it up, so look for that within the hour. I'm going to read the safe harbor statement and then Greg is actually going to read the CEO letter this one last time unless EDGAR goes down another time in the future, just so you can have a chance to listen to the themes and look at the slides. But they are on again the new section of svb.com and on the IR section as well.

Well, first of all, Greg Becker and Dan Beck as you know as usual are here to talk about our third quarter financial results and there are other members of management, who will join them for the Q&A. The release was posted where I indicated and we'll be making forward-looking statements during the call. Actual results may differ materially. We encourage you to review the disclaimer in our earnings release dealing with forward-looking information, which applies equally to statements made on this call. In addition, some of our discussion may include references to non-GAAP financial measures. Information about those measures including reconciliation to GAAP measures may be found in our earnings release.

Thanks and I will turn the call over to Greg Becker.

Greg Becker

Great, thanks Meghan. So I'm going to take the CEO letter and just read through majority of it, but I will just kind of highlight some key parts. So with that we are pleased to report strong third quarter earnings per share of $5.15, net income of $267 million and a return on equity of 18%. Our performance is the result of a solid operating environment, effective execution against our strategy and robust client acquisition. Our financial results reflect excellent balance sheet growth, solid core fee income and healthy market-related gains, underpinned by continued stable credit quality.

Our strong financial results demonstrate the power of SVB’s place at the center of the global innovation ecosystem and the ways in which our strategy and values reinforce the foundation we’ve laid for long-term growth. Our long-term commitment to innovators and investors enables us to understand their businesses, give advice and solve their problems to improve the probability of their success. The following themes summarize our view of Q3 and the current market environment: 1) Healthy markets, the robust liquidity of our clients and our own strong execution are fueling growth in our core business globally; 2) We have achieved our target of 10% net interest income sensitivity; 3) Core fee income continues to grow strongly across the board alongside solid contributions from warrants and investment securities; 4) Credit remains stable and the risk profile of our loan portfolio has improved significantly over time; 5) We’re maintaining strong capital and liquidity, which gives us flexibility to adapt and to take advantage of opportunities in a changing environment. Our strong capital position provided the foundation for a new 350 million share repurchase authorization, effective over the next 12 months; and 6) Our preliminary 2020 growth outlook is positive, with the expectation of solid performance and continued investment in products, people, systems and processes to support our growth in the future.

Regarding markets, Venture Capital investment remained strong in the third quarter for a total of $97 billion invested in nearly 8,000 companies year-to-date, easily on pace for a second successive year of investment greater than $100 billion, given the trend towards fewer, larger investments. This healthy VC activity was reflected in our strong new client acquisition, with another quarter of more than 1,200 new core commercial clients. This robust client acquisition is consistent with Q2 and continues the trend that has resulted in net new client growth of nearly 70% since 2015. Our access to the best innovation clients and our ability to increase the likelihood of their success and continue to add value as they grow remain key differentiators for us.

Third-quarter exit activity stabilized somewhat following the flood of pent-up IPOs in Q2, but remained strong. VCbacked exit values for 2019 year-to-date crossed the $200 billion mark for the first time in a decade, with more than 80% of all exits year-to-date occurring via IPO, another first for the industry. 70% of U.S. venture backed companies that went public during the quarter were SVB Clients. This activity contributed to approximately $38 million in warrant-related gains in the third quarter.

VC fundraising reached $30 billion year-to-date and appears to be on track for another strong year, on top of which, the realized returns to investors from this year’s IPOs will soon be flowing back into the system, ripe for reinvestment. U.S. private equity investment remained strong in the third quarter with the number of deals year-to-date on pace to match 2018, despite a weaker economic backdrop. As a result, 2019 PE fundraising year-to-date has already reached full-year 2018 levels. This backdrop of continued investment, fundraising and demand provides a healthy environment for our clients and for us, as we continue to execute on our strategy of enhancing client experience, improving employee enablement, enhancing risk management, and driving revenues and scalable, long-term growth.

Let me transition to our balance sheet and total client funds. Average total client funds growth of 5% to $150 billion primarily reflected growth in technology, with contributions from our private equity/venture capital and our international portfolios, due to healthy funding and exit markets for our clients, as well as the strong new client acquisition. Average on-balance sheet deposits increased by 8.1% to $57.2 billion, average interest-bearing deposits grew by 22% to $18.1 billion, due to the success of new products related to our deposit growth initiatives. Total deposit costs increased by 2 basis points, as our pricing adjustments were offset by strong volume growth. Our deposit cost remains very low at 38 basis points. Average non-interest-bearing deposits returned to growth, increasing by $1 billion to $39.1 billion. Non-interest-bearing deposits now constitute 68% of total deposits, compared to 72% in Q2.

We are increasing our full-year deposit growth outlook from the low double digits to the low teens, as a result of our better-than-forecast deposit growth, the momentum created by our deposit growth initiatives and the continued strong liquidity of our clients. We expect the majority of deposit growth for the remainder of 2019 to occur in interest-bearing products. Average loans grew by 1.4% to $29.8 billion, on track to meet our full-year outlook. Growth was driven primarily by private equity capital call lending, which now constitutes 52% of the loan portfolio, and by continued growth in our Private Bank lending. At the same time, liquidity from the strong equity funding environment, and our continued credit discipline, continue to provide headwinds to growth in our technology and life science lending.

Despite these pressures, the pace of loan growth for the full year remains on track with our forecast and late-quarter borrowing activity in Q3 has created strong momentum going into Q4, as evidenced by period-end loan growth of $1.9 billion to $31.1 billion during the quarter. Loan yields declined by 41 basis points during the quarter, driven by lower rates, portfolio mix, lower loan prepayment fees and interest recoveries compared to Q2, as well as the market environment.

Average fixed income investment securities grew strongly by 8.7% to $25.1 billion and yields remained stable at 2.58%. New purchases totaled $5.4 billion at 2.43%. This represented a decrease of 36 basis points from the prior quarter, but was nevertheless accretive to net interest income and helped to drive our asset sensitivity lower. Maturity yields were 2.43% versus 2.25% in the prior quarter. Based on the current level of interest rates, the average tax-effected yield on new investments for the remainder of 2019 could be between 2.15% and 2.25% and overall, we expect the yield on the investment portfolio to remain flat.

Moving to interest margin and net interest income. Net interest margin and net interest income declined during the quarter, primarily reflected strong balance sheet growth as well as the impact of market rate declines and a number of non-rate related items. Net interest margin declined by 34 basis points to 3.34%, majority of this decrease 21 basis points was due to growth in earning assets. This included growth and interest bearing deposits and high quality but lower yielding loan categories as well as higher cash balances related to our strong client liquidity. 7 basis points were directly related to the impact of lower prime and library rates. Another 6 basis points of decline came from the market environment including competitive loan yield compression and the impact of interest recoveries in Q2.

The majority of our loans tied to LIBOR reset during the quarter limiting impact of LIBOR in future quarters, assuming no additional changes in the forward curve. We expect Q4 NIM to be between 3.25% and 3.3%. Net interest income decreased by 1.6% to $523.6 million primarily due to the impact of lower interest rates, two-thirds of this decrease $11.4 million was related to the impact of lower fed fund rates on Prime based loans, cash balances and interest rates swaps and lower rates in LIBOR index loans. The remainder $9.1 million was from non-rate related items including lower interest rate recoveries versus Q2. These decreases were partially offset by the impact of strong balance sheet growth during the quarter, which contributed an $11.8 million increase in interest income.

Consistent with the comments we made in our Q2 2019 we are reducing our full-year 2019 outlook for net interest income and net interest margin following two additional decreases in the fed funds rates in July and September. We expect full-year 2019 net interest income growth in the low-double digits versus our prior outlook of the low teens. We expect full-year average 2019 NIM of 3.5% to 3.6%, 10 basis points lower than our prior outlook. We are succeeding in our efforts to manage the impact of rate decreases on our net interest income sensitivity to no more than 10% and 100 basis point shock scenario.

Our primary strategies underlying this effort are interest rate swaps, continued extension of our fixed income securities portfolio and adapting our deposit pricing to market rates. We will continue to actively manage assets sensitivity to the 10% target. Based on our expectations for the impact of our balance sheet strategies for the rest of 2019, we're forecasting a $35 million to $45 million annualized pretax reduction and net interest income for each 25 basis point fed funds decrease, which equates to approximately 2% of our net interest income. This estimate assumes deposit beta and our lower rates of between 50% and 70% and continued deposit growth primarily in interest bearing accounts.

During Q3 we continued to see strong growth in our core fee income lines as well as gains from warrants, investment securities, and our investment banking business. Our core fee income has grown 28% year-to-date compared to the same periods last year, particularly driven by client investment fees, credit cards and foreign exchange. This continued growth in core fee income provides a welcomed offset to downward pressure from rates.

While out market-driven income streams are harder to predict. We've seen very good warrant and investment security gains year-to-date and thanks to help you funding in exit environments for our clients. And while we expect our client markets to remain healthy, we do not anticipate that 2020 warrant an investment securities gains will match 2019 levels. Income from SVB Leerink was slower in the third quarter. Expectations for SVB Leerink revenues are slightly lower for the year as MNA revenues have been weaker than anticipated. However, the market for SVB Leerink continues to grow and they're maintaining consistent market share. We have solid expectations for that business in 2020 assuming the markets remain healthy.

Moving to credit, credit quality remains solid in the third quarter with strong underlying metrics and no change in our outlook for 2019. Credit performance reflects growth in high quality loan categories such as private equity and private bank as well as the gradual improvement of our risk profile, including a decrease over the years of our earliest stage of loans to only 5% of our loan portfolio. Based on the high quality and short duration of our loan portfolio we are expecting the impact of CECL Adoption to be primarily reflected in an adjustment to our reserves for funded and unfunded credit commitments, related to the requirement to reserve for the life of our technology and healthcare loans versus the one year reserve horizon in place in the current standard.

We estimate that day one CECL Adoption implementation will increase combined reserves by 7% to 16% due to the higher lifetime inherent risk in our technology and life science portfolios. This increase will be reflected in equity. We expect increased volatility and reserves going forward depending upon economic conditions in forecasts. We'll continue to refine our estimates of Q4 and are on track for implementation on January 1, 2020.

As we have in prior years we want to provide our preliminary outlook for 2020. In 2020 we expect continued solid performance and opportunities for growth even without the help from interest rates. Our preliminary outlook is based on our expectations for healthy client liquidity and activity, although potentially less robust in 2019 and stable credit quality barring a significant deterioration in the economy.

In addition to strong balance sheet in core fee income growth, low-single digit net interest income growth is stabilizing NIM and credit quality consistent with 2019; we are forecasting non-interest expense growth in the high single digits. These expectations assume no future rate decreases. For 2020 assuming all of our preliminary guidance and the impact of two additional fed rate decreases in 2019 we expect full year net interest margin between 3.10% and 3.2% and net interest income comparable to 2019 levels.

Our actual results will be impacted by a variety of factors including the mix of interest bearing to non-interest bearing deposits, the mix of deposits to off-balance-sheet client funds and certain market related factors.

In summary, we posted a solid Q3 performance. Hove a positive outlook for 2020 and outlined long-term growth catalysts. Our continued strong performance in health and liquidity of our clients make us a positive about our business and growth prospects. As always, we're keeping a close eye on any challenges that might arise from health of our markets and the broader markets. Interest rates remain on an area of focus, but we believe our lower asset sensitivity and flexibility with regard to expense growth will enable us to better manage the impact of declining rate environment.

Competition is challenging as is ever has been from banks, non-bank financial service providers and liquidity in the markets. We will continue to take every opportunity to raise our game in the face of competition. In the long run we believe our unique approach networks and insights will continue to differentiate us while our ongoing investments in products and capabilities will enhance our ability to compete globally.

Well the potential impacts of an economic downturn on credit is in many people's minds in this respect we believe are better than positioned because we've been lowering our risk with fully 79% of our assets in high quality investments and low credit lost experience lending. In addition to these advantages, we have a high quality, high liquid balance sheet and a client base that's demonstrated resilience during downturns. We believe the investments we're making in geographic expansion, enhancements of our digital client experience and diversification of our business and with people and systems will provide the foundation for long-term profitable growth and operating leverage.

In the meantime, we're enjoying the growth and flexibility enabled by our strong capital liquidity and are competent and diversified high quality balance sheet. We remain focused on being the most valuable partner to innovators and their investors, ensuring we remain at the heart of the innovation economy globally so that we can continue to see and support the best new companies year-after-year and forge lasting bonds with our clients as they grow.

With that I'm going to open the call to questions.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] And our first question comes to Ken Zerbe from Morgan Stanley. Your line is open.

Ken Zerbe

Great, thank you. Good evening everyone.

Greg Becker

Hey, Ken.

Ken Zerbe

I guess maybe a good place to start. In terms of sort of that just the tech lending. We've seen a fair amount of volatility in the tech space and I guess, we can also include some failed IPOs. So one of the concerns is that, that it could be having effect on your business. I know loan growth – average loan growth is weaker this quarter. And you're pretty optimistic about next quarter, but could you just address that the concern around some of the volatility in the tech space and is that having any meaningful impact on how you think about growth? Thanks.

Greg Becker

Yes. Ken, this is Greg. I'll start and I'm sure Mike or Marc may have things to add. So we had – we've seen little impact at all from the few IPOs that are getting the attention. I guess, it's important to note if you look at the IPOs through the course of the year that have gone public for the most part with the exception of a few many have actually performed very, very well and you can look at the amount of money that's being returned back to limited partners, venture capital firms and limited partners is a great catalyst for that to continue to grow. And despite that timing of those IPOs that were softer during the earlier part of the year. Again, we've not seen a slowdown in liquidity. We've not seen a slowdown in activity over all the portfolio and we actually don't believe it's going to have a meaningful impact on the outlook. From our view, it's pretty isolated.

Ken Zerbe

Okay, great. I guess, and then just in terms of the hedging – not hedging strategy. But just in terms of mitigation of – of the impact that's how you're down below 10%. Can you just elaborate a little bit more like are you done trying to mitigate the asset sensitivity at this point. Is there more to come and how should we think about that? Thanks.

Dan Beck

Yes, Ken. It's Dan. At this point, as you said, we're right at the 10% asset sensitivity limit for a year period and we continue to pay attention to that. We think that is a good level for us at this point as has always been in our thought because we can continue to grow over time through that 10% limit. So we are going – continuing to actively watch it and manage to that 10% limit. But for now, we're comfortable that we're in the right spot.

Ken Zerbe

Got it, okay. And then just one last question. I want to make sure I understand the guidance for 2020. So in 2020, if you do get an October cut, which I think is pretty likely and another cut in sometime in say mid-2020. Is that your guidance that NII is going to be stable and NIMs 3.10% to 3.20%?

Dan Beck

So Ken, we took the approach of looking at a fed funds decrease in October as well as December. Just to provide that as a scenario. And that scenario is where we think its comparable year-over-year and that NIM being between 3.1% and 3.2%.

Ken Zerbe

All right, perfect. Thank you very much.

Operator

And your next question comes from Aaron Deer from Sandler O'Neill. Your line is open.

Aaron Deer

Hi, good afternoon, everyone. Just following up on Ken's question with respect to the operating environment and sentiment out there, I'm just curious – is it your sense because you sound pretty optimistic that the venture community in general is still being pretty rational in terms of valuations and such as because with some of the pullbacks we've seen in some of these things. I would think that maybe would suggest maybe we're do for another reset, or maybe a slowdown in activity, like we had back kind of during the 2015, 2016 period, but it sounds like you're not anticipating that at all?

Greg Becker

So Aaron, this is Greg. We really haven't seen it. Do I think that we're going to end up seeing some pullback in valuations with some companies? Yes, I believe that will be the case. Do I think there is going to be more discussions around board tables about corporate governance? Yes, I think that's probably going to be happening as well. But I actually, I think all those things are healthy and the investors that we're talking to, is that they still look at the number of companies and the quality of companies and the upside these companies present and there is talking with a very optimistic tone. So yes, you could see some valuations come down, but I don't right now. My crystal ball would say, I don't look at this, like a early 2015 experience that we saw. Now that's right now and again things could change but I don't see it in my crystal ball.

Aaron Deer

Okay, I appreciate that. And then, it looked like you had some decent growth in the private bank in the quarter, but capital call lines still kind of leading the way with those inching up toward your – your kind of soft ceiling on that. What are the efforts you're making to kind of squeeze better growth out of the private banks since it seems like that's an area where you guys could have a lot of upside in growing the book?

Mike Descheneaux

Aaron, this is Mike Descheneaux. Maybe there's two kind of points that you actually bring it, one is on the, I would say capacity of the growth for private equity, the other one is on the mortgage side of the private bank side. And let's start with the private bank side. You're right; there is a big opportunity for us there, particularly when the rates are being lower. There's lot of refi opportunities as we continue to grow that we definitely see opportunity in that area. So that's something I think where – you will see more of in the future.

With respect to the private equity side and as you see that business has performed exceptionally well, it’s a business we like and we definitely are going to continue to grow. I mean, when you look at the credit performance there. When you look at the amount of capital that we have, we definitely have ample room to continue to grow in that area, so you'll expect to continue going there and as you know, that's a very sizable market and a big opportunity for us. So we feel very good about where we're at and where we're going to go.

Aaron Deer

Okay, great, thank you for taking my questions.

Greg Becker

Hey, Aaron. This is Greg. I'll maybe just add on to it. Clearly, the growth has been from private equity and the private bank. But I also want to highlight that technology banking and life sciences; we've actually had a really strong year for originations. It's just not translating from originations to funding because of that liquidity that I talked about. So what we're seeing is a really good uptake and some of those deposits we're talking about which is driving the business are helping to drive the business is actually coming because we're adding in a healthy way technology companies and life science companies. It just isn't translating to loan outstandings in that portfolio because of that liquidity environment.

Operator

And your next question comes from Steven Alexopoulos from JPMorgan. Your line is open.

Steven Alexopoulos

Hi, everybody.

Greg Becker

Hi Steven.

Steven Alexopoulos

I want to start of the loan side. So I'm trying to reconcile the slower growth in average loans versus the very strong growth in period end loans. Could you walk through that again?

Greg Becker

Yes, this is Greg. I'll have a couple of comments and Marc is going to add I'm sure. With private equity lending, I mean, you do get periods of time where you can have pretty big swings and it was just a slower growth in the first part of the quarter and you ended up in this spot where just toward the end, you saw a pickup and that's held. So as I said in my comments and the outlook. We feel very good about that period end being a good starting point into Q4 and that it's going to hold. So it was just more of a slow part for the first part of the quarter and that dramatically picked up toward the end, but again we feel that's going to hold.

Mike Descheneaux

The one thing – Steve, this is Mike Descheneaux. The one thing to remember as well as going back to Q2 about how significant the growth was in the private equity world in Q2. So you almost think about as a little bit of digesting, if you will, so to speak. But again, as Greg pointed out, we're starting Q4 in a really good way where that period end number is about $1.2 billion greater than the average that we have for Q3.

Steven Alexopoulos

Okay, that's helpful. And then on the hedging, how much in terms of the hedges that were added this quarter, how much of that cost of NIM, how much pressure that put on the margin?

Dan Beck

So Steve, if you look at the entire hedging book, its right at about $4 billion right now and if we look at the overall cost associated with that. It's right at 45 basis – 40 basis points. So assuming we get a fed fund decrease in October, the total net cost associated with that will be down to about 15 basis points. So in the quarter to answer the question specifically was about a $2 million drag on net interest income. But the overall cost of that program at this point on a basis point basis is 40 basis point.

Steven Alexopoulos

Okay. And then finally, I appreciate the CEO letter calling out the impact or thoughts around NIM if we do get more rate cuts. But along those lines looking at the preliminary 2020 outlook, if the rate cuts continue, how do you think about that expense guidance that you're pointing to right now?

Dan Beck

Yes. So as we talked about it, if you think about what we're doing on net interest income. The key for us is, again, proactively managing the asset sensitivity and we've taken major steps to do that with the hedge program starting effectively from zero at the beginning of the year ending right now at $4 billion, continued extension of the investment securities portfolio and floors in the book. So we're managing that asset sensitivity. At the same time as we look at our expense guidance being in the high-single digits. If we do get additional decreases, we will look. There is some flexibility at least in project spend and things along those lines.

But we still believe that there is an important aspect in our investment and continuing to invest not only in scalability initiatives which are under way right now. But secondly to continue to expand what we're delivering in a digital way to our customers. It's a highly competitive environment, and we need to continue to reinvest to do that. So we have flexibility to the extent that we need to use it and we see additional rate decreases. But that will largely be timing of that project spend more than anything else.

Steven Alexopoulos

Okay, terrific. Thanks for answering my questions.

Operator

And the next question comes from Ebrahim Poonawala from Bank of America. Your line is open.

Ebrahim Poonawala

Good afternoon, guys. Just a quick question in terms of the deposit mix. Dan, if you can talk about your outlook, as we think about 2020 guidance, does that still assume that majority of the growth is coming from interest-bearing deposits. And to that end, if you can talk to the leverage to reduce the funding costs as we get an October cut and potentially December cut, just the pace of the decline we saw about 10 basis point reduction in the third quarter?

Dan Beck

Yes, so first of all, yes. We do expect a continuation of the addition to deposits being interest-bearing related. So, we think on a full year average next year will be in the – let's just call it mid-60% range of total non-interest bearing deposits to total deposits, that's going to come down a bit from where we're going to exit Q4. As we look at pricing and pricing on that portfolio. You did see that we did make some changes in the fourth quarter; we look at our deposit beta assumptions. We are tracking along with them and the expectation is that we'll be able to continue to make those changes with additional rate decreases in 2020.

Ebrahim Poonawala

Got it. And the 8 basis points decline we saw in your money market deposit, should that pick up pace as we think about next quarter and into 1Q if you get a couple more rate cuts or?

Dan Beck

Yes, there is a – just the timing of rate decrease effects. So that will naturally drive at least some additional reduction as we get into the fourth quarter. We'll also be continuing to consider deposit pricing actions. To the extent that we get additional rate decreases. So you will, assuming just by the passage of time, you will see some additional decrease in the deposit cost.

Ebrahim Poonawala

Got it. And just taking a step back, I think the one question that comes up is historically growing non-interest bearing deposits has been a sort of a strong suit for SVB, given your size and given sort of what's happening in terms of the funding rounds and the cut – the size of the funding rounds. Is it reasonable to assume that the kind of non-interest bearing deposit growth that's made up historically your funding that's not likely as we think about going forward or do you think that we do see some reacceleration in NIB growth at some point in the near future?

Dan Beck

I think just like moving into a rate increase cycle, moving out and into a rate decrease cycle. Our customer behavior is incredibly difficult to predict. And I think that with these large dollars of funding increases, folks have in that higher rate environment certainly been looking for an interest bearing product to the extent that we get a cut in October, we get another potential cut in December. You are starting to get a lower rate, and we'll be watching customer preference, I think that's really what it relates to is the rate environment. That's why we enjoyed that benefit for such a long period of time. We're going to continue to acquire funds and it's just a question of at what point rates get to a point where it matters – matters less.

Ebrahim Poonawala

Got it. Thanks for taking my questions.

Operator

And our next question comes from Jared Shaw from Wells Fargo. Your line is open.

Jared Shaw

Hi, good evening.

Greg Becker

Hi Jared.

Jared Shaw

I guess looking at the preliminary guide for fee income for 2020. Where are you really seeing a lot of that growth coming from and how much of that is going to be dependent upon a rebound in Leerink?

Greg Becker

So, this is Greg. So I'd love to think about the core banking side of the house commercial banking side, and then we'll talk about Leerink. So from a core banking perspective, you're going to see it primarily in three different places, right. So FX, you're going to see it in the client investment fees and cards will be the three areas. So those are the three areas. And again, even though the growth looks like it's flowing from last year or from this year, you basically have to kind of take out the additional rate increases and benefits we got from the client investment fees.

So net-net, it's really not that different when you factor that out of it, so again another healthy year of growth. With SVB Leerink obviously, there is three ways to think about it. One is, where is there – how are they positioned in the market relative to the market, right. So they’re – partially if the markets stronger they will do better if not they will – obviously that will drop compared to that. We think next year is going to be a good year. And it's – can they gain market share and the area that we're working closely and the team is working closely is again ECM really good, they're building up the M&A practice. And so to the extent that practice builds out that more, that's going to be stronger and they feel good about that.

And the last part is again the reason we brought Leerink onto our platform is not just what they're going to drive themselves, but it's the cross polymerization. And it's the help that's driven into our life science and healthcare commercial banking. And I would tell you that the synergies between the two has been exceptionally strong and we've already seen several loans and client fund wins that we can point to specifically having them on our platform. And that is a – that we believe is going to be a driver for many, many years to come. So it's the combination of all three of those things, but yes Leerink will have an additional contribution in 2020.

Jared Shaw

Okay, thanks. And then you’d mentioned the success of the exit – of the exits this year and then seeing some distributions back to the LPs. Should we expect to see that that puts any pressure on balance sheet funding as you go into the end of the year as some of those distributions are made? Or is it going to be masked by overall growth?

Dan Beck

Jared, it's Dan. So as we looked at our deposit expectations for the rest of the year, we did factor in some slower growth and some additional distributions just similar to what we saw last year. So again, it's very, very difficult to predict with any certainty, but we've incorporated the best estimates we can of fund distributions into our estimates on a full-year basis.

Jared Shaw

Okay, thanks. And then just finally for me with the buyback announced or the new buyback announced, could we see that be executed faster than over the next 12 months? If there is a good market opportunity or are you really looking at trying to have that be executed sort of sequentially throughout the year?

Dan Beck

I mean, it is – it's dependent upon market – market forces and what's going to happen as we get into the rest of the year. So it's really just highly dependent upon what's happening from on the external side. We've set that 12 month threshold, just like we did with the previous buyback and we'll continue to monitor that throughout the year.

Jared Shaw

Great, thanks so much.

Dan Beck

Yes.

Operator

And your next question comes from Chris McGratty from KBW. Your line is open.

Chris McGratty

Great, thanks. Dan, you guys built a ton of cash in the quarter. I guess, you mentioned in the assumptions behind deploying at normalizing those levels lower as it relates to your margin and NII outlook?

Dan Beck

Yes. So we have been and you saw it and what we deployed in the quarter, deploying those investment securities this previous quarter deployed them at about 2.43%. As we look ahead, obviously the deployment rates will be a bit lower. So looking at on a tax effected basis something closer to, let's call it 2% to 2.1%, so we're putting that money to work at the same time the way that we're looking at deposit pricing and off balance sheet pricing is that we would expect some migration or additional migration to off-balance sheet. Those types of things are not going to happen immediately. Those are things that happen progressively over time. But the expectation is we'll be managing the cash levels down either through deployments or through the management of pricing and pricing products on versus off-balance sheet.

Chris McGratty

Great. And then maybe one more on the client fee, the fee rate on the way up was about call 1 basis point for 25 basis points. Is there any delay in kind of reducing that rate? Or is it kind of when we get October, it's another basis point kind of projecting that out?

Dan Beck

Yes. So we've been holding at 20 basis points of fee income across client funds from the first two rate decreases that we saw. We have an expectation and we've incorporated that in our guidance of – for every new 25 basis point rate decline, we see about 1 basis point of rate deduction. So that's what we continue to expect and we probably start to see that with the potential October fed funds decrease.

Chris McGratty

Okay, great. Thank you.

Operator

And your next question comes from Brock Vandervliet from UBS. Your line is open.

Brock Vandervliet

Good evening. I was trying to work on a number of questions. Could you talk a bit about credit quality to start, I guess, in terms of just giving us a little bit more of a granular feel in terms of the net charge-offs. I guess it was about $33 million in the quarter, part of that was early to mid-stage companies. Could you discuss a bit more?

Marc Cadieux

Happy to. This is Marc Cadieux here. And so, the charge-offs this quarter were higher, driven by two loans as you see in the release if you've had a chance to get there yet. And those two loans we think got into difficulties for reasons very specific to each of those credits. Those two loans by the way are in totally different industries, different stages of development, et cetera. And as mentioned before became troubled for unique factors that by extension we don't believe are indicative of any emerging adverse trends. When you set aside those two, what's left is a very typical quarter if you were to compare it to pretty much any quarter in the last three, four, five years. We will always have a handful of granular investor dependent loan charge-offs and that's again what you see in the third quarter. So, really, it's not too terribly different aside from those two larger ones that again we don't believe are indicative of any adverse emerging trend.

Brock Vandervliet

Okay, great. And I guess going back to the very first question in terms of the dislocation seen among some of the most noteworthy companies and things – in kind of a world that's been awash in capital and investment, could we kind of flip the script and see a pickup in terms of lending activity to the core early and mid-stage companies?

Greg Becker

Yes, this is Greg. I'll start. That's possible, but I think the question is – there's two questions, right. So one is do we think that the liquidity levels are going to change in any dramatic way? As we said in kind of the script, do we think 2020 is going to be as healthy as 2019. We said, now, we’re kind of expecting it will be a little more tempered than it was, but still very healthy. When you're out talking to limited partners, remember, they're going to get a flood of cash back to them. And I think enough of these limited partners have looked and basically said, especially in a low rate environment like this, innovation is where the best growth is going to come from. And so, I don't think from that standpoint, we're going to see any meaningful change in liquidity. Now again, if it softens a little bit from where it was in 2019, where it is right now, could we see a pick-up related to that, because we won't have that funny enough headwind maybe, but I wouldn't count on anything dramatic change in there. I do believe, we believe that our origination levels will continue at a healthy pace into 2020. And we're obviously working on products that can help increase loan outstandings in that area. But I wouldn't say, it's going to have an impact or be impacted by the liquidity in the market, because that won't change a whole lot from our vantage point.

Brock Vandervliet

Okay, thanks for the color.

Operator

And your next question comes from Gary Tenner from D.A. Davidson. Your line is open.

Gary Tenner

Thanks, good afternoon. I just want to go back to a comment Mike that you made I think with regard to private equity lending and commenting on how successful that business has been with good credit dynamics. Should we read through that that there is that 55% number is perhaps not a hard cap and as things go you may go through that.

Mike Descheneaux

That's right. I mean, again, we believe we have ample room and there is a number of ways you can look at concentration with respect to kind of PES. We talk a lot about the loan piece of the equation again with respect to other total loans. But when you look at as a percentage of total assets, or when you look at the gross profit that it contributes, it's far less than those 55% concentration numbers. So we continue to look at it, we feel very good as you know, the credit quality is excellent, returns are good, liquidity is good. So it checks all the right boxes, but again we just continue to assess it, but as at this point, we feel very good about the business and we're going to continue.

Gary Tenner

Thanks for the clarification.

Operator

And your next question comes from David Chiaverini from Wedbush. Your line is open.

David Chiaverini

Hi, thanks. I wanted to start with on the competitive environment, you mentioned about how 6 basis points of the NIM decline came from the market environment including competitive loan yield compression. I was wondering to what extent could competitive pressures continue to weigh on yields and are these competitive pressures increasing or decreasing?

Greg Becker

Yes, this is Greg. And is competition increasing? Yes, competition is increasing. And it's not surprising again when you look at opportunities for growth, one of the biggest areas, one of the only areas for growth is the innovation economy. And so that's what you see, when it was inclusive of the private equity business, inclusive of the tuck-in life science business, it's from banks, it's from non-banks et cetera. As we say we believe our differentiation and our strength and we think about our market share, our market share has been consistent and we are continuing to expand our product set. So, that we can even stay longer with clients and provide even more differentiated loan products and services. That's what we're doing. And so, the one thing about competition as much as none of us likes it, it makes us all better and stronger.

Do I think we would be as innovative in our products and services if we didn't have competition? No, that probably wouldn't be the case. And so, we look at that as saying it's just the – it's the price of being in a market that is growing and that doesn't surprise us. So could there still be some compressions or there could be still some compression? So we specifically called out market – market dynamics because there's two pieces to it. One is just competition. And second one is looking at from a risk perspective. And again private equity service is a great example. It is a lower risk loan portfolio. And so as you compete in that market space, there are firms out there that have – there is low risk and there is exceptionally low-risk. Those command a high or lower yield. And so, the market is dictating part of that. Competition does as well, but the market does, based on the risk. So all of those things are factored in and we think about margin compression related to the market.

David Chiaverini

Thanks, that's helpful. And then shifting to the securities portfolio, is the duration at the point where you're comfortable with the duration or do you expect to extend that further?

Dan Beck

Yes, this is Dan. I think as we add additional securities purchases, we'll continue to extend out duration, probably not materially from here. It came down a bit in the quarter, but that was mostly just due to the impact of lower rates as we bought kind of out in that four year to six year maturity timeframe. So we're comfortable with that. And just the addition of securities at that four to six year maturity, we'll continue to slowly extend duration.

David Chiaverini

Great, thanks very much.

Operator

Thank you, ladies and gentlemen, this concludes the Q&A session. I'll now turn the call back over to Greg Becker, Chief Executive Officer.

Greg Becker

Great, thanks, again. Apologize for the problems of getting out the press release. I understand that EDGAR is up and running and you can find all the information directly there, like you normally would. It just came up in the last kind of 20 minutes or so. But I guess, despite that challenge, hopefully, you guys got enough time to digest what we talked about. And when we look at the quarter, we ended up again feel really good about the quarter. We had incredible liquidity. We had great period in loan growth. Core fee income was strong. And the investments that we're making, we are feeling very, very good about. And we expect to be introducing a lot of those products and services and client experience enhancements in 2020. So we're looking very forward to 2020 not just because of the outlook that we outlined, but because of the different products and services we are looking to release in 2020 as well.

So again, I want to thank everyone for joining the call. I want to thank our clients for not only trusting us, but I would say inspiring us based on what they're doing in the market. And I always say, we have the best clients of any institution anywhere in the world and the same is true for our employees. So I want to thank them as well. With that, thanks for joining us again and have a great day. Take care.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.