Goldman Sachs Group's (GS) Management on Q3 2016 Results - Earnings Call Transcript

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Q3: 10-18-16 Earnings Summary

SEC *10-Q*

EPS of $4.88 beats by $1.05 | Revenue of $8.17B (19.05% Y/Y) beats by $761.06M

Goldman Sachs Group Inc. (NYSE:GS) Q3 2016 Earnings Conference Call October 18, 2016 9:30 AM ET

Executives

Dane Holmes - IR

Harvey Schwartz - EVP & CFO

Analysts

Glenn Schorr - Evercore ISI

Christian Bolu - Credit Suisse

Michael Carrier - Bank of America Merrill Lynch

Matt O'Connor - Deutsche Bank

Mike Mayo - CLSA

Betsy Graseck - Morgan Stanley

Guy Moszkowski - Autonomous

Fiona Swaffield - RBC

Jim Mitchell - The Buckingham Research

Chris Kotowski - Oppenheimer

Brennan Hawken - UBS

Steven Chubak - Nomura Securities

Matt Burnell - Wells Fargo Securities

Eric Wasserstrom - Guggenheim Securities

Devin Ryan - JMP Securities

Brian Kleinhanzl - KBW

Marty Mosby - Vining Sparks

Operator

Good morning. My name is Dennis, and I will be your conference facilitator today. I would like to welcome everyone to the Goldman Sachs Third Quarter 2016 Earnings Conference Call. This call is being recorded today, October 18, 2016.

Thank you. Mr. Holmes, you may begin your conference.

Dane Holmes

Good morning. This is Dane Holmes, Head of Investor Relations at Goldman Sachs. Welcome to our third quarter earnings conference call.

Today's call may include forward-looking statements. These statements represent the firm's belief regarding future events that, by their nature are uncertain and outside of the firm's control. The firm's actual results and financial condition may differ possibly materially from what is indicated in those forward-looking statements. For a discussion of some of the risks and factors that could affect the firm's future results, please see the description of Risk Factors in our current annual report on Form 10-K for the year ended December 2015.

I would also direct you to read the forward-looking disclaimers in our quarterly earnings release, particularly as it relates to our Investment Banking transaction backlog, capital ratios, risk-weighted assets, global core liquid assets and supplementary leverage ratio and you should also read the information on the calculation of non-GAAP financial measures that's posted on the Investor Relations portion of our website at www.gs.com.

This audio cast is copyrighted material to Goldman Sachs Group Inc. and may not be duplicated, reproduced or rebroadcast without our consent. Our Chief Financial Officer, Harvey Schwartz, will now review the firm's results. Harvey?

Harvey Schwartz

Thanks Dane and thanks to everyone for dialing in. I'll walk you through the third quarter and year-to-date results and am happy to answer any questions.

Net revenues were $8.2 billion, net earnings $2.1 billion. Earnings per diluted share $4.88 and our annualized return on common equity was 11.2%. For the year-to-date, net revenues were $22.4 billion, net earnings $5.1 billion, earnings per diluted share $11.24 and our annualized return on common equity was 8.7%.

Relative to the first quarter of this year, the second and now the third quarter, have shown steady improvement. This improvement is reflected in third-quarter revenues, which increased 19% year-over-year. We also had a modest sequential increase which is particularly noteworthy given the third quarter is often seasonally slower.

A few factors contributed to the enhanced operating environment. The markets generally improved with equity prices steadily moving higher. The S&P 500 was up 3.3% in the third quarter. The MSCI World increased by 4.8% and the VIX declined by 15%.

Credit spreads also tightened during the quarter with U.S. investment grade and high yield cash spreads tighter by 12 basis points and 87 basis points respectively. In addition, there weren't any major changes to the global economic outlook over the course of the quarter. For example consensus estimates for global GDP growth remained roughly consistent.

Ultimately a more favorable backdrop and improved client sentiment translated into year-over-year revenue growth in three of our four business segments. Now let's discuss them.

Investment banking produced third quarter revenues of $1.5 billion, 14% lower than a strong second quarter. Although revenues declined sequentially, our investment banking backlog remained robust and was up versus last quarter. Breaking down the components of investment banking in the quarter, advisory revenues were $658 million down 17% compared to the second quarter as industry-wide completed activity declined.

Year-to-date Goldman Sachs ranked first in worldwide announced and completed M&A. We advised on a number of significant transactions that closed during the third quarter, including ARM holdings £24.4 billion sale to Softbank Group. AGL Resources $12 billion merger with Southern Company and Lockheed Martin's $5 billion spinoff and merger of its IS&GS business into Leidos.

We also advised on a number of important transactions that were announced during the third quarter, including WhiteWave Foods $12.5 billion sale to Group Danone. Hewlett-Packard Enterprises' $8.8 billion spin off and merger of non-core software assets with Micro Focus International and Abbott Medical Optics' $4.3 billion sale to Johnson & Johnson.

Moving down to revenue, revenues were $879 million in the third quarter, down 11% sequentially, due to a decline in both debt and equity underwriting. Equity underwriting revenues were $227 million down 16% compared to the second quarter due to a continued weak backdrop for equity issuance.

However the end of the quarter was significantly more active in the beginning with more than half of the quarter's IPO volume occurring in September. Debt underwriting revenues of $652 million were down 10% quarter-over-quarter, following a robust second quarter.

For the first nine months of the year debt amortizing produced record year-to-date results. During the third quarter, we actively supported our client's financing needs, participating in Postal Savings Bank of China's $7.4 billion IPO, Great Plains Energy's $2.5 billion follow-on and convertible offering to support its purchase of Westar and Fortis' $2 billion investment grade offering for the purchase of ITC.

Turning to Institutional Client Services, which comprises both our FICC and equities businesses, net revenues were $3.7 billion in the third quarter up 2%compared to the second quarter. FICC client execution net revenues were $2 billion in the third quarter up 2% sequentially.

Credit increased and benefited from strong primary issuance and tighter spreads. Mortgage also increased and included better market-making conditions even tighter spreads. Rates was down slightly as client activity was driven by the continued discussion around potential Central Bank actions.

Currencies was essentially unchanged compared to the second quarter with lower client activity, particularly post the Brexit vote and commodities declined during the quarter as activity remained light. In equities, which includes equities client execution, commissions and fees and security services, net revenues for the third quarter were $1.8 billion up 2% quarter-over-quarter.

Equities client execution net revenues of $678 million were up 16% sequentially, reflecting better market-making conditions. Commissions and fees were $719 million, down 3% quarter-over-quarter. Security services generated net revenues of $387 million down 8% relative to the seasonally stronger second quarter.

Turning to risk, average daily volume in the third quarter declined to $57 million, down $5 million sequentially. Moving on to our investing and lending activities, collectively these businesses produced net revenues of $1.4 billion in the third quarter. Equity securities generated net revenues of $920 million, reflecting company-specific events, sale and gains in public equity investments.

Net revenues from debt securities and loans were $478 million and included approximately $275 million of net interest income. Investment management we reported third-quarter net revenues of $1.5 billion up 10% from the second quarter as incentive fees, management fees and transaction revenues all increased.

Assets under supervision increased $37 billion sequentially to a record $1.35 trillion. The increase was due to net market appreciation and net inflows. Long-term fee-based net inflows of $14 billion were primarily driven by fixed-income products.

Now let me turn to expenses, year-to-date compensation and benefits expense, which includes salaries, bonuses, amortization of prior your equity awards and other items such as benefits declined by 13%. This was roughly in line with net revenues.

The 13% year-to-date decline results in a compensation to net revenues ratio of 41%. This is a hundred basis points lower in the funds accrual in the first half of this year. Third-quarter noncompetition expenses were $2.1 billion down slightly compared to the second quarter.

Now I would like to take you through a few key statistics. Total staff was approximately 34,900 roughly flat with the second quarter. Our effective tax rate for the year-to-date was 26.9%. Our global core liquid asset ended the third quarter at $214 billion and our balance sheet was $880 billion.

Our common equity Tier 1 ratio was 14% using the standardized approach. It was 12.4% under the Basel 3 advanced approach. Our supplementary leverage ratio finished at 6.3%. In the quarter we repurchased 7.8 million shares for $1.3 billion.

In terms of capital, our ratios have significantly strengthened over the last several years. This reflects the transformation of our balance sheet and our cumulative effort to de-risk the firm. All of these actions, combined with more than $30 billion of earnings since 2011, position the firm to grow our capital ratios and simultaneously bring our basic share count to its lowest point ever.

Before I wrap up, I want to cover three topics, our client franchise, expense initiatives and new opportunities. With respect to global client franchise, it's in great shape. We have a strong position in each of our four segments, investment banking, institutional client services, investing in lending and investment management.

While many of our clients are currently challenged by the low growth environment, we are committed to partnering with them and they look to navigate these headwinds. On expenses, last quarter we discussed the $700 million savings initiative that we undertook in the first half of the year and we continue to look at additional means of improving our efficiency without impacting our global client franchise.

Focusing on operating efficiency, not only positions us for margin expansion in better environments, but it also provides additional benefits. It allows the firm to maintain its global footprint and to continue to invest in the future, which is an essential component of sustainable value creation.

While there are currently economic headwinds in several countries globally, our focus on efficiency across all of our businesses and regions allows the firm not only to maintain, but also to invest in our client franchise through the cycle. Additionally, our expense discipline allows us to invest in new opportunities. Last week we launched a new online personal loan platform Marcus by Goldman Sachs.

Marcus' goal is to enter the consumer credit market and provide a product that is simple, transparent, flexible and provides consumers with real value. Like any new effort, we are taking a slow and methodical approach with Marcus. We are leveraging all the firm's pre-existing strengths across risk management and technology and we have brought an experienced team of consumer lending professionals to drive Marcus forward led by Harit Talwar.

Before taking your questions, I would like to leave you with one thought. The firm is as focused on navigating today's environment, as we are on preparing for the future. You have to do the first really well to be in a position to do the latter. Thanks again for dialing in and I am happy to answer your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question is from the line of Glenn Schorr with Evercore ISI. Please go ahead.

Glenn Schorr

Hi thanks.

Harvey Schwartz

Hey, good morning, Glenn.

Glenn Schorr

So I appreciate the color around things related to FICC and I've a question of overall backdrop. In the first quarter of '15, the Swiss re-pegged stuff went bonkers for a couple weeks and you made tons of money even more than the overall industry. This quarter it didn't seem like there was too many aha moment.

Credit spreads tightened and they had aftermath of Brexit and stuff, but in your text you point out low rates and slow economic growth as headwinds for FICC. You talk about lower market firms and volatility and equities.

I'm just curious when you look at the quarter we just had in FICC particularly, is it more like you had a nice pickup like first quarter of '15 and you're setting this up for keep calm like things have returned back to normal or is this possibly a little bit higher activity environment given the uncertainty?

Harvey Schwartz

So it's a great question, year-over-year we were up 49% on a core basis. I think in some respects that speaks to a weaker third quarter environment last year, but I have to agree with you. I wouldn't say it was a particularly strong quarter for FICC. Year-over-year I talked about some of the drivers.

I would say maybe the best way to describe, it wasn't so much -- it wasn't so much about tailwind as it was about not having so many headwinds in the quarter and of course we translated nicely for us.

Glenn Schorr

I'll take it if it will get a little bit higher operating environment. One last one on I&L, it's interesting that multiples -- take up multiples were near their highs and you would expect a lot of exits. This one happened to be a better quarter. You talked about some company-specific events, some sales and the up markets, but I guess the question is, is are you finding opportunities that will also put money to work especially on the equity side.

I saw the UFC deal and I am a huge Conor McGregor fan, but that was close to six times, the six times cap. So curious about how you see the investing environment for I&L?

Harvey Schwartz

So the opportunities for a while have been more on the debt side. You've seen the I&L balance sheet transition. When you see it again this quarter it is going to close to 80% debt, but selectively we're certainly seeing opportunities whether they be in what we recall other forms of equity, real estate or other areas, but selectively we've seen some good opportunities in corporate equity. As you're probably seeing, we're in a market now raising a fund, and the reception to that has been quite strong.

Glenn Schorr

How big is the I&L balance sheet now? You said its 80% Fixed Income, but it's over 100 now?

Harvey Schwartz

So just to give you the exact number, it's 98.9 billion, [indiscernible] just under 99 billion, and that's up $1.8 billion quarter-over-quarter. And I said almost 80%. It's 78% really debt and other assets, which leaves you basically with $21.5 billion of what we would categorize as equity.

Glenn Schorr

All right. Awesome. Thanks. Harvey.

Harvey Schwartz

Sure. Thanks.

Operator

Your next question is from the line of Christian Bolu with Credit Suisse. Please go ahead.

Christian Bolu

Good morning Harvey.

Harvey Schwartz

Hey Christian.

Christian Bolu

So a question on your consumer lending efforts, given the firm will be facing a very different demographic than you have historically faced, may we just talk about how you think about reputational risks and how you mitigate it?

Harvey Schwartz

Yes, so it's a great question. So I think the short answer is providing value to the consumer. So one of the reasons we have said so many times and this is going to be a very deliberate and methodical approach and a bit of crawl before we walk in this business is because we're well aware that this is a new effort for us.

Now and some of this is not new for us, our technology skills, the risk management, but the interface through the technology with this new important client base, it's a different space for us. So we've hired, obviously, people with decades of experience. But I think the greatest mitigating factor is slow growth, monitoring it very closely.

But also, when we put this together, we took input from consumers, and it really is, I don't know if it's the first-ever, but it’s really is a lending product that is driven by consumer input. And so that means providing them with flexibility, with real value, with simplicity. And that's why we've come out with something, and we got feedback, consumers don't necessarily like and they don't understand the fee structures.

So we created a no-fee product, no small print. If you call our call centers, people pick up. Some of these things are simple, but they're quite important in terms of what consumers want. And if you deliver what consumers want and you really control your processes, then obviously, you create value and you deliver what regulators want also.

Christian Bolu

Okay. That's helpful. And then just a cleanup question. On the buyback, $1.2 billion in the quarter, which is a bit lower than the first half run rate. I know the last CCAR cycle buybacks were back-end weighted. How should we think about the pace for this cycle?

Harvey Schwartz

So you're right. A year ago, there were some [indiscernible] that attach, which led to more backend weighted profile. This year, we had a bit of flexibility in terms of how we'll approach the next couple of quarters, but a lot of this i6s going to be driven by edging out the environment and demand for the balance sheet.

We would really like to start putting our capital to work if the environment improved from where it is today. But certainly, there's some flexibility in the profile for us to go up a little bit from these levels. But again, certainly not committing to that. You know how we think about capital management, and share repurchase for us is not to be equated with dividends and so it's going to be dynamic.

Christian Bolu

Okay, thank you Harvey.

Operator

Your next question is from the line of Michael Carrier with Bank of America Merrill Lynch. Please go ahead.

Michael Carrier

Thanks Harvey.

Harvey Schwartz

Hi, Mike

Michael Carrier

Can you just first, question on capital ratios. Your ratio continues to improve. Based on we had some recent comments by [indiscernible] and where CCAR is heading into '18, did anything change in how you managed through that process?

And then just with your last comments on the last question on balancing buybacks versus investments, are you starting to see some opportunities to make investments? And maybe it's because of market share opportunities globally but just wanted to get your thoughts on that.

Harvey Schwartz

So again, on the ratios, as I mentioned, 14 under standardized and 12 4 are advanced. By the way, just [indiscernible] and I'll know I get the question Mike, its 13.4 standardized fully phased and 11 9 on the advanced fully phased.

In terms of the stress testing, white paper and govern it relates comments I'd say at a high level, obviously, they put a ton of work into this with various constituencies. We – our initial frameworks were their framework seem quite awful. And it seems somewhat consistent with the way we actually manage the firm. So we manage the firm obviously on the forward-looking basis in terms of how we stress tests.

We obviously also manage the spot capital ratios. And under our spot capital ratios, as you can see, we have lots of capacity. And so we'll have to see ultimately the details in the MPR, but again, they did the right thing here by giving the bank the opportunity to make adjustments because as you know, this won't be incorporated into the 2017 cycle.

And so the extent to which firms need to adapt, will be able to adapt after we see the MPR. But I think our starting point puts us in a great position and again the treatment of share repurchase and we'll see what happens with balance sheet and other things. But we'll take our normal approach in terms of capital management from here. But it seems like the right direction.

Michael Carrier

Okay. And then just a quick follow-up on I&L. When you look at some of the things that the Fed has put out there on physical commodities and some of the pressures on that part of the market versus what you guys have been doing on the debt side, just where do you see the outlook based on maybe some of these potential changes, the increase in RWAs? And what you can still grow versus what could potentially be at risk?

Harvey Schwartz

So that's a great question. In terms of why we just talked about commodities MPR. So the market's been waiting for this for a while. As you know, we've been in the commodity business for decades, and we think it's really important that the Federal Reserve’s taken the lead here in terms of an important area of focus for us in the industry, but especially as it relates to ultimately establishing uniform standards across the industry. So we welcome all that.

With respect to our business, we've obviously been very vocal in our commitment to the commodity business, and some of that I think maybe that gets misunderstood. So I want to underscore for you a bit. What we're committed to is serving our clients and their needs and you kind unpack that a bit and simplify by saying there's really three activities that are critical to our clients. It's critical for them to hedge, and that's consumers and producers would have commodity price exposure.

Financing of those businesses is critical. And then obviously, market-making activities, which provide liquidity to the markets under a critical component of making those markets function. That's what we're most committed to. You've seen over the years, we've been reducing on balance sheet, investing in commodities.

And so we'll work with the industry and with regulators like we would in any MPR process. But what we're more focused on ensuring that those services from a Goldman Sachs' perspective and across the industry can get provided to clients in a safe and cost-effective way. No different than if we were to approach any of the MPRs.

Michael Carrier

Okay. Thanks a lot.

Harvey Schwartz

Thanks Mike.

Operator

Your next question is from the line of Matt O'Connor with Deutsche Bank. Please go ahead.

Matt O'Connor

Good morning.

Harvey Schwartz

Hi Matt.

Matt O'Connor

I was wondering if you could talk a little bit more about the targeted customer base for the [indiscernible] platform in terms of FICO scores, income or however you're defining it?

Harvey Schwartz

Yes. So with this launch and with this one product, we're focused on the prime borrower base.

Matt O'Connor

And I guess, how do you define prime? I mean, it's a pretty big segment overall.

Harvey Schwartz

So we would define it broadly for you. Let's just say above 650 FICO category.

Matt O'Connor

Okay. And then just over time, will you provide more disclosures on this? Because as I step back and look at some of the names I cover, there seems like it could be one of the meaningful new initiatives that's out there in terms of change in the profile the company a little bit, and I think more disclosures over time will be helpful to be able to track the performance.

Harvey Schwartz

Sure. We're happy as it grows, obviously as it becomes more meaningful, I mean just to underscore this. I got an e-mail last that we booked our first loan. So if you want to continue, if you want to consider that continuous updating of financial disclosure, Matt, but I don't mean to make a lot of your question.

Obviously, as it grows and becomes more meaningful, we'll spend more time with you on it. I think the important thing now is that, we make sure that everyone understands the product, the pace we expect to move at, which will be very deliberate and slow. And that in terms of return for long term, if that's kind of where you're getting, obviously, I talked a lot bit about the consumer here but we built this business to be accretive in the long run to Goldman Sachs returns. But we're certain, we're happy to keep you updated.

Matt O'Connor

Okay. And then completely unrelated, any color on the regional performance within fixed income trading this quarter?

Harvey Schwartz

No. There was nothing specific that jumped out. It was really more across the products but it wasn't anything, particularly in the regional clouds.

Matt O'Connor

Okay, all right. Thank you.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Mike Mayo with CLSA. Please go ahead.

Harvey Schwartz

Good morning, Mike.

Mike Mayo

Hi in the past, you've mentioned that you felt some competitors were having a more permanent retreat from the market. Did you see some of the benefit of share gains this quarter as part of your capital markets revenue? And also your comp ratio was up 100 basis points year-over-year. Are you trying to hire more people or pay more in an effort to gain share?

Harvey Schwartz

So with respect to the market share, certainly over the course of the past year, I would say there's been periods, particularly things like some of our core strengths, Prime Brokerage in fixed income, across the regions, we've seen discrete shifts in market share. I would say when we look at it in terms of the core businesses, for example, like credit, as we monitor those market shares, certainly with certain client segments like asset managers, it feels like we're picking up market share. Again, one of the difficult things about market share is you really need volume to grow.

And even though obviously our performance this year significantly better than last year, it's the best quarter we've had in five quarters. You really need activity levels to pick up from here. Now just in terms in the second part of your question, the 41% of this 49 is our best estimate.

We told you forever that as a conceptual matter, you should expect in periods where revenues should decline that compensation and benefits expense should lag that and obviously, we talked to you ton about operating leverage. And so as revenues grow, you should also expect compensation and benefits expects to lag that growth because of the operating leverage. But at this stage 41% an output.

Mike Mayo

And one follow-up. Brexit, is this a chance to gain additional share? Or is this just pain that everybody has to share? And do you think more business shifts to the U.S.?

Harvey Schwartz

I would say that Brexit potentially is something that could drive share to the U.S. I think what we've witnessed over the last several years is U.S. firms like ourselves with really, really strong market shares and leading business positions whether you look at FICC, investment banking, equities, asset management, if you're a leader in a franchise throughout this cycle, particularly as activity picks up, I think there is share to gain. I think our European clients need us. But in terms of Brexit, I think it's unclear whether that's having any impact at this stage. It feels like early days.

Mike Mayo

All right, thank you.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Betsy Graseck with Morgan Stanley. Please go ahead.

Betsy Graseck

Hi good morning.

Harvey Schwartz

Hi Betsy, how are you?

Betsy Graseck

Hi good. I just had a couple of questions. Looking at the VaR that you guys put out in your note obviously in the press release. It seems like volatility actually came down a bit in certain segments and yet the VaR came down as well. And I look at this and I'm thinking is there an opportunity for you to allocate a little bit more in this environment and continue to generate some nice sized trading revenues?

Harvey Schwartz

So I think that observation is correct. I think what's most important about that observation is just the capacity we have under the capital ratios, so obviously. But again, VaR is going to be driven by market volatilities and by client demand. And as client demand picks up or as market volatilities pickup, certainly you would expect that to translate through. We're not feeling constrained at all really only by the macro environment and our client appetite is same.

Betsy Graseck

So in this past quarter it was more function of client demand pulling back because it feels like you have the capital capacity to have had more of allocated this past quarter?

Harvey Schwartz

When you look at it in terms of so you are talking about year-over-year sequentially and you look at -- sorry, my allergies [ph] are bad today. If you look at more sequentially it's kind of mix of our total level is coming down and what I'll call position changes. If you look at year-over-year it's more about position changes. I think your big point is this environment wasn't a particularly strong environment, again it's the third quarter it's got some of the seasonal characteristics.

Betsy Graseck

Yes. Okay. And then just secondly on Asia, could you give us a sense as to how you guys are reorienting your Asia franchise, I noticed that there was some headcount changes over there and some management changes, so could you give us a sense as to what the strategy is for that region?

Harvey Schwartz

So, as you remember from the last call, we talked about the expense initiatives we launched in the first half, which translated to $700 million run rate savings. Anything you are reading in a press is a bit distorted. This process in Asia it just a continuation of the process that has been ongoing for the rest of the firm. In terms of Asia completely committed to the region.

Betsy Graseck

They make sense. I'm just saying I think there is also a comment around the Head of Asia was changing and so wondered if there was a shift in focus on?

Harvey Schwartz

No, they are completely unrelated events. If you're sitting at Magic Me [ph] yesterday you would have heard Mark talked about how we joined the firm in 1976 and he just thought this would be a perfect time for him. But now they are completely unrelated in terms of there is nothing strategic in that.

Betsy Graseck

All right. Thanks.

Operator

Your next question is from the line of Guy Moszkowski with Autonomous. Please go ahead.

Guy Moszkowski

Good morning.

Harvey Schwartz

Good morning, Guy.

Guy Moszkowski

I wanted to follow-up on the I&L questions. Specifically, maybe you can just give us some color, maybe some examples, of how you have been continuing feed the equity balances to offset the gains harvesting that you have been doing over the past couple of years.

Because you've harvested quite a bit, and yet you have been able to maintain that asset line item in the $21 billion, $21.5 billion range. And in the context of that, maybe you can comment on some of the recent proposals or requests that the Fed has made for congressional action to tighten up.

Harvey Schwartz

So in terms of I&L balance sheet, again you are right to point out that $21 billion, $21.5 billion have been relatively constant. Obviously, that from a smaller component of the balance sheet I mentioned before it's close to 8% and 8% is really lending another item. And so I don’t have details in front of me to give you blow-by-blow breakdowns on where reinvestments are occurring. Obviously, corporate private equity has been slow over the last couple of years, but that $21.5 million 20% of that now is made up of real estate globally.

And so that's been a meaningful participant. Now why have you generally not seen the asset class going lower? Obviously it's about high class problem. The assets have been performing, the markets have been generally going up over the last couple of years and you've seen that performance as I&L segment. So that's part of the gives and gets. In terms of I think you are -- I think -- I don’t think you are much talking about brokers you are talking about the fed discussions with congress, very early days and we'll see how that evolves, is that your question?

Guy Moszkowski

Yes, I think that there was some -- there was -- before the commodities NPR came out the fed had also I think made some noises about asking for congressional guidance I guess on cutting back on merchant banking that's allowed within broker.

And I was wondering if you had some sense of whether you would be able to continue to seed that equity line and keep it in the range that it's been in or grow it if in fact there're further restrictions on merchant banking.

Harvey Schwartz

Well, obviously the opportunity exist, we think we are providing an important layer of capital, but these conservations evolving, it's super early, so there'd be no way for us to interpret or give you any guidance on that.

Guy Moszkowski

Fair enough. I guess the other question, also I&L-related is, and had this has to do with the negative operating leverage comment that you had made for the Firm broadly. So for the nine months, your revenues are down; your comp is down not as much, maybe a couple of percentage points differential, which is a negative operating leverage.

But the biggest component of the revenue decline has been I&L. My question is, if I&L had declined in line with the rest of the Firm, would it be possible to keep the comp declining in line as well? In other words, would you have been able to maintain your margin better if it hadn't been I&L that was driving the revenue down?

Harvey Schwartz

So on the competition benefit expense you are right, so revenues are down 15%, you relate any competition benefit expense down 13. Now I wouldn't -- maybe we characterize that as negative operating leverage I don't know that's meaningful negative operating leverage and the reason we are able to achieve that almost lock step decline, it was because of the expense initiative we launched in the beginning of the year.

In terms of contribution of an individual segment, we look at this as firm wide collective as we go through the competition process. And obviously competition as we repeated to you many times before, it's about performance, but it's also about managing the company for the long term and executing our strategy for the long term. So it's not going to be a -- a competition process not going to driven by one segment contribution one way or another.

Guy Moszkowski

Okay. That's helpful. I appreciate it.

Harvey Schwartz

Sure. Thank you.

Operator

Your next question is from the line of Fiona Swaffield with RBC. Please go ahead.

Fiona Swaffield

Hi.

Harvey Schwartz

Good morning.

Fiona Swaffield

I just wanted to ask -- good morning. About pricing you mentioned -- we talked about market share, but have you seen given that some banks putting less capital to work than others, any impact on pricing in any of your products, and there is the follow-up as well on the tax rate now that is coming lower again what are you thinking about for the future? Thank you.

Harvey Schwartz

So in pricing at the margin it's very business specific, we have seen in some cases that I'll call a rational re-pricing and things like prime brokerage. But again in this low volume environment I don’t know how much that you will see, in other words, the same low volume, low growth environment we have globally that's contributing to what it looks like in the future extraordinarily strong competitive environment for our businesses is the same thing that doesn’t allow for lot of price improvements.

And so I think these one of your things where even though it has taken while you need environment that is challenge for a while or to get competitors retreats of the same challenges don’t allow for price adjustments, it maybe overtime you see price adjustments, but certainly things the more capital intensive parts of the business like prime brokerage where we are market leader. In terms of tax I think in terms of your estimate obviously it will be driven by regional contributions, but I would say 28% to 29% that range.

Fiona Swaffield

Thank you.

Harvey Schwartz

Thank you.

Operator

Your next question from the line of Jim Mitchell with The Buckingham Research. Please go ahead.

Harvey Schwartz

Hey Jim. How are you?

Jim Mitchell

Good. How are you doing, Harvey?

Harvey Schwartz

Good.

Jim Mitchell

Maybe just a question on Asia I guess in a more positive way, you have the Hong Kong, Shanghai connect going into place later this year, it seems like when the Hong Kong Shanghai connect went in you guys had a nice boost in equity trading the industry did in the first half of 2015. Do you expect something similar this time around?

Harvey Schwartz

I don't know, necessarily we have a strong view in terms of the immediate. I do think that over the intermediate term it's an important development. I think more broadly, well it might not be a straight path to increasing volumes, I think more broadly in Asia our perspective is and with China that we are on a long upward trajectory of activity and our role and ability to work with clients in the region, whether its trading, advisory, capital raising, this just feels like a very long positive trajectory, but it's not going to be straight line.

Jim Mitchell

Right okay. Fair enough. And then maybe a follow-up on the pipeline. You guys did note you're down year-over-year. Is that mostly M&A and can you give any more color on what you're seeing in terms of the outlook on the pipeline?

Harvey Schwartz

So the pipeline feels pretty good when you talk our M&A team. And the backlog sequentially was up, not down. But the activity levels that I mentioned in terms of completed transactions in the market, obviously down over year after very, very healthy levels.

The best perspective I can share with you is the one I get from talking to our M&A bankers. And it hasn't shifted much over the course of the year. The same fundamental factors that are contributing to the last two years of M&A activity, generally low topline growth, a desire to drive efficiencies, access to the capital markets, all those factors still in place.

Now regionally the U.S. field is more active then Europe and Asia fields a bit more active than Europe, but I am giving you really very localized commentary. Long-term it feels like the fundamental factors are in place.

Jim Mitchell

And the underwriting side of the equation?

Harvey Schwartz

So in underwriting as you saw, we've had very strong debt performance and we had a record for the first nine months of this year on a year-to-date basis. I mentioned before that half year IPO volume or meaningful portion of the IPO volume actually occurred in September.

So it does feel like we are starting now again into a market where a lot of that activity that got pushed from the first quarter into the second quarter that that still exists. So we feel reasonably good about activity levels in the capital markets on an intermediate basis.

Jim Mitchell

Okay. Great. Thanks.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Chris Kotowski with Oppenheimer. Please go ahead.

Chris Kotowski

Yes, I wonder if you could give us some more color on the new private equity fund? I saw a press report saying it's between $5 billion and $8 billion. But if you could just comment on the targeted size and mandate? Is it global or North American? Is it pure corporate equity, or is it broader? And then as a follow-on to that, if it's $5 billion to $8 billion, the Blackstones and Apollos of the world are raising $18 billion-plus. So what's the strategy to put the money to work? Is it to go more middle market? To do fewer deals or to bring in more co-investors? Those kind of my questions.

Harvey Schwartz

No I am happy to talk about it. I don't know if I'll get to all of your questions, but let me just give you the high level. So we are in the market, there is really two fundamental reasons why we decided to engage in the fund raise. One was really to have a full offering for our private wealth clients.

And the second is if you look at the capital regime particular under CCARs as it related to private equity, corporate equity specifically, those capital requirements continue to adjust. So they are giving us the flexibility to utilize the funds and to provide that to our clients. It seem like it made a ton of sense.

Now in terms of the fund size, we have been talking about $5 billion to $8 billion, that’s what the team feels is the right size for the horizon that they are thinking about. So they are not looking the raise the largest one of the world despite the fact that there’s been very significant interest in terms of how we are approaching it and in terms of its focus, its focus will be on corporate private equity.

Chris Kotowski

Okay. And should we assume that you will commit 3% to it? And is it the standard asset management 1% and 20%? And I assume that these will show up on the asset management side? And then kind of related to that, is this all a wealth management, asset management, standalone business that's walled off from investment banking? Or can there be cross-pollination between the two?

Harvey Schwartz

Well the activities, the activities allow for us obviously to work with our investment bankers, but it is an asset management driven product and its broker compliance, in its design.

Chris Kotowski

Okay. All right. Thank you.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Brennan Hawken with UBS. Please go ahead.

Brennan Hawken

Good morning. So first question on non-comp. I think you took a charge here in occupancy. Is there some benefit that we should see flowing through in subsequent quarters from that occupancy charge this quarter?

Harvey Schwartz

Yes. So we took a $63 million charge. This relates to one asset that we leased out. The run rate on that is small, but generally speaking, we look at these things, we look for a reasonably short term in terms of payback, in terms of recouping those expenses but this has been something we were just waiting for the market to recover, but it's a small item.

Brennan Hawken

Okay. And then, hoping to ask a follow-up for your previous comments on FICC. I think you commented that the quarter wasn't a particularly strong one, even though the year-over-year growth was good. And it seemed like you commented that you are gaining share in FICC, at least among some market participants.

But if we look at year-to-date trends in revenue, it does look like some of the U.S. money center banks are growing double digit plus over 2015 year to date, whereas Goldman's revenue is down. Can you help us understand maybe why that's diverging? Is it a business mix issue? Is there something else going on? Are you shifting away from certain clients or what have you? Any help you could give us there, Harvey, would be great.

Harvey Schwartz

Yes. It's no problem. I think that's more environment-specific. So it could be in some aspects, different footprint. All these businesses at this stage in FICC, and we don't have much visibility in FICC competitors, they're all very different. Some of these are enormous balance sheets. Some of them are very big in emerging markets, some are not.

I think when you look at it I wouldn't overemphasize the first quarter '15, which I think is really the factor that's influencing your math. And again I wouldn't overemphasize the performance that we had in the third quarter either, because things just don't shift that quickly.

I think that the third quarter was solid for us. But as I talked about currencies, commodities was down year-over-year. So it certainly wasn't an environment we were hitting on all cylinders and even with that, we were in a double-digit ROE environment. So it feels pretty good to us and the momentum feels good.

Brennan Hawken

Okay. Thanks.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Steven Chubak with Nomura. Please go ahead.

Steven Chubak

Hey Harvey, Wanted to start off with just a follow-up question relating to the earlier merchant banking discussion. Recognize that many of the recommendations are, in fact just that, that have come from the regulators. But just thinking about the strategy for this business, longer term, looking at the activities more broadly, it's been a very good profit source, historically, but it also consumes significant amounts of capital.

And under a CCAR lens, some have speculated it could even be ROE dilutive overall. I was wondering, given the current backdrop and some of the high-end regulatory scrutiny, whether you have considered strategic alternatives for the business, such as an IPO or a spin that could generate value while maybe allowing for some degree of regulatory unshackling?

Harvey Schwartz

So I think you're right to underscore, which I mentioned earlier, the fact that over time, the CCAR requirements under -- let's just use private equity investing and corporate equity have certainly increased. Now the nice thing about that analytic framework is it's perfectly transparent with the global market shops are etcetera. So you can certainly evaluate investments that you're making.

Now we're talking about investments at the bottom part of the capital structure and so in terms of the return profile, we're obviously very selective about how we deploy that capital. But as I mentioned before, one of the nice things about launching this fund is it does gives us flexibility in terms of how to think about deploying that capital and it creates a new important product for our clients. So we have options.

Steven Chubak

Got it. Okay. That's very helpful color, Harvey. Thank you and maybe just one follow-up on the capital side. Actually, we're shifting over to the denominator. It is quite evident that you have made significant strides in mitigating your standardized RWAs. I think it's down about 15% since the end of 2014. But the advanced risk rated assets have actually crept higher.

I know some of that is going to be a function of increases in op risk. But I was hoping you could speak to any mitigation potential that you can achieve on the advanced risk rated assets moving forward, particularly if the Collins floor does end up applying to some of the new proposed capital changes that Tarullo spoke to in his recent remarks.

Harvey Schwartz

Yes. So as I mentioned on the advanced transitional, we're at 12.4% under the current capital regime. Obviously, that gives us more than enough capacity. We obviously have things that roll off and things like that, but not material enough for me to highlight for you.

But to the extent to which I think at this stage whether you look at the supplementary leverage ratio, standardized, advanced, we have the tools in place through our return on attributed equity framework, the ROE framework, which we talked a lot about.

We have the tools in place at this stage and more importantly, the culture, the people engagement across the entire firm. We will adapt if needed but right now we feel we have more than enough capacity.

Steven Chubak

Got it. Thanks for taking my questions.

Harvey Schwartz

Sure. Steve.

Operator

Your next question is from the line of Matt Burnell with Wells Fargo Securities. Please go ahead.

Matt Burnell

Good morning Harvey. Thanks for taking my question. Just a couple of quick ones. You mentioned that there was the strongest inflow of AUM in the quarter was in fixed income. Any color as to what was driving that and if those were -- was that all liquidity or was it slightly higher margin flow?

Harvey Schwartz

No. So liquidity products, I believe, it's up $2 billion in the quarter. So this was long-term fee-based assets that were really the driver. And the team has done a very good job in their advisory businesses and so that I would say would be the more meaningful part of the driver in terms of this quarter's flows.

Matt Burnell

Okay, and just circling back to another question previously asked. If I back out the charge that you took in occupancy this quarter, it looks like, as well as litigation, it looks like you are running in the last couple of quarters at around 24%, 25% non-comp to revenue ratio.

I understand revenue can be a bit volatile, but it's been trending prior to that at 30%-plus. Is 25% a new run rate? Or is it really going to depend -- should we really think more about the dollar value rather than the ratio?

Harvey Schwartz

We don't target a ratio. You should think of the ratio as an output. Now obviously, we have been very diligent around expenses over the last couple of years reflecting the environment. If you happen to have a lot of historical financials, you would see that market development this quarter was under $100 million.

I think it's the lowest it's been in seven years. So obviously we've been very focused on this, but we don't target a ratio. And a big driver obviously is BC&E and if you saw big activity pickup, that would move with the environment as well. But we're very focused on expenses as you know.

Matt Burnell

Yes, thanks very much.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Eric Wasserstrom with Guggenheim. Please go ahead.

Eric Wasserstrom

Thanks very much. Hi, how are you Harvey? Just to step back for a moment, can we just talk about how we should contemplate revenue growth across the mix of businesses more broadly? Because I look at what happened this quarter and what's occurred over the course of the year. And in the underwriting businesses and in the advisory business, obviously you know the statistics much better than I. But advisory may be moving to a new, lower plateau than what we've seen recently. And with all the cross currents running through the trading environment and through the investing environment, how do we contemplate the overall go-forward mix of business?

Harvey Schwartz

So I think we don't target the mix, as you know. We focus on the clients in those businesses where, as you know, we have leading market positions and so we feel good about that. I think it's a bit more of what's your expectation for the environment is.

We control the micro issues we can focus on, our client engagement, expenses, capital management. But a lot of the things are outside of our control and I would say that in aggregate, when you look at the vast majority of our businesses, this is not an extraordinary environment, despite the fact that third quarter performance was strong on a relative basis, there's lots of challenges regionally.

You could certainly envision an environment that was significantly better from where we are today. You've heard us say this a lot, but we look for growth and an environment of negative interest rates in vast parts of the world is not indicative of a role that's growing at great pace. So you could see much better environments than we have today, and we hope that ends up being the case.

Eric Wasserstrom

But just from a planning perspective, I mean is there any reason to think that, or that this environment, that those policy dynamics are changing over, let's say, a medium-term horizon?

Harvey Schwartz

Just like I think they could change always pretty quickly for a negative, and we tend to be more contingency planners. You could certainly see things break for the high side. Obviously, rates could move back into positive territory, which should be an indicator and there's been speculation in the market that we might be more in the cusp of that in the United States.

I think the most important takeaway is whether or not we move into that environment in the near term? We're incorporating all those current factors in how we're running the firm today, which in a pretty muted environment, we're able to grow revenues, demonstrate a double-digit ROE and we truly believe we're well positioned in the franchise with significant operating leverage if the environment improves. So we feel quite good about our position, but we are rooting for a better environment for everybody.

Eric Wasserstrom

And if I could sneak in one last one on Marcus. Most firms that do similar kind of lending typically have a 2.5% to 3% pre-tax ROA. How does that compare with what it is you are targeting?

Harvey Schwartz

So that's perfectly consistent with what we're able to generate. Of course, we don't have any legacy infrastructure cost structure. This is all white sheet of paper for us. So we'll see how it evolves, but that's certainly achievable.

Eric Wasserstrom

Okay. Thanks very much.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Devin Ryan with JMP Securities. Please go ahead.

Devin Ryan

Thanks, good morning, Harvey.

Harvey Schwartz

Hi how are you, Devin?

Devin Ryan

Good. So it seems like we are speaking a lot more about your technology footprint on these calls. And you have been increasingly highlighting a number of those capabilities. When we look at those initiatives, like Marcus or Symphony, Marquee, or consolidating the electronic trading book across businesses, and maybe I missed something there, but where do you see the most immediate opportunities to actually move the needle?

And I guess that's part one. Part two is as you think about future investments in the technology, do you think more of the incremental spend from here is going to be more offensive positioning, revenue-producing, rather than defensive?

Harvey Schwartz

So it's a great question. I would say that broadly speaking, and this won't be completely inclusive, but I think you can define our technology strategy as focused on client engagement and those tools and services we can deliver to clients that provide differentiated value to those clients, and you see that doing us in our capital markets businesses and obviously you see us creating that with Marcus.

Two, there are times when we feel like given our core technology skills, we're in a position to develop technology, which will be better enhance outside of the firm ultimately even though we incubated it in the firm, and Symphony will be a great example of that. We feel like as an information sharing platform with better security, better compliance controls, we felt like that was something better utilized by a broad range of market participants.

And lastly, our own technology internally is quite important for making us more efficient and adapting to regulatory change and managing our risks, and that's obviously been very core to what we do. So we look across all three of those different platforms if you will, for lack of better language.

I would say the most important thing in addition to controlling the firm is our client engagement and Marcus reflects that trend as it relates to consumers.

Devin Ryan

Got it, that's great. Very helpful. Maybe just a quick follow-up. Just any update on the momentum in deposit gathering within the online bank? Just how that has been, I don't know if you give any numbers there, but how that's been maybe relative to expectations now that we are a little ways away from the launch?

Harvey Schwartz

So it's more than exceeded our expectations. I think in the past quarter, we picked up another $1 billion of deposits and so the momentum there feels quite good and the team's done an excellent job of transitioning the platform into Goldman.

Devin Ryan

Got it, okay. Thanks very much.

Harvey Schwartz

Thank you.

Operator

Your next question is from the line of Brian Kleinhanzl with KBW. Please go ahead.

Harvey Schwartz

Hey Brian.

Brian Kleinhanzl

Hi Harvey, actually I'm all good. All my questions were asked. Thanks.

Harvey Schwartz

Okay. Great. Thanks, Brian.

Operator

And your next question is from the line of Marty Mosby with Vining Sparks. Please go ahead.

Marty Mosby

Thanks. Going back to the comp ratio, and what you said earlier about as revenues go higher, the comp ratios should really drift lower. As we are having lower revenues this year, the comp ratios should probably drift a little bit higher than it was last year. Is that the concept you were really pushing forward earlier?

Harvey Schwartz

So this is completely consistent, Marty. As you know, you've been following us forever in terms of broadly speaking and it may not be the case in any given year. But broadly speaking, we've encouraged you to expect that compensation and benefits expense will lag revenue moves.

So you've seen it through the first -- through the year-to-date. 41% is our best estimate but revenues are down 15%; compensation and benefits expense, down 13%. In environments where revenues are up, base case, you should expect a lag in that direction also particularly given how much we've emphasized operating leverage with you.

Marty Mosby

That is what I thought. I've just been spoiled the last two year with revenues being fairly consistent on a year-on-year basis.

Harvey Schwartz

Yes.

Marty Mosby

The other thing I was going to ask was, you had mentioned you had four businesses, which is outlined on income statement very clearly. When you talk about the new consumer business and lending, it really doesn't fit into any of those four. Do you feel like you could put deposits maybe in asset management? But are you thinking about this as evolving into a fifth business? Or how would you tuck it into your overall strategic mix today?

Harvey Schwartz

So three of the four segments are up this year obviously. The one segment, which we worked hard to unpack for everybody is Investing & Lending and this would very naturally fall into the lending segment. Obviously, to the extent to which down the road as an activity in and of itself, if it had material contribution, we could talk about highlighting more, but I think it will give a lot of attention as it grows anyway, it's pretty exciting.

Marty Mosby

Got you. Thanks.

Harvey Schwartz

Thanks Marty.

Operator

At this time, there are no further questions. Please continue with any closing remarks.

Harvey Schwartz

So since there are no more questions, I just really want to take a moment to thank all of you for joining the call. Hopefully, I and other members of senior management will see many of you in the coming months.

If any additional questions come up, please don't hesitate to reach out to Dane or the team. Otherwise, please enjoy the rest of your day and I look forward to speaking with you on our fourth quarter earnings call in January. Take care, everyone, and thanks again.

Operator

Ladies and gentlemen, this does conclude the Goldman Sachs third quarter 2016 earnings conference call. Thank you for your participation. You may now disconnect.

Comments (0)