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Capital One Financial Corporation (COF) CEO Richard Fairbank on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $3.32 beats by $0.40 | Revenue of $6.96B (-0.04% Y/Y) misses by $-231.85M

Earning Call Audio

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Capital One Financial Corporation (NYSE:COF) Q3 2019 Results Conference Call
October 24, 2019 5:00 PM ET

Company Participants

Jeff Norris - SVP, Finance

Richard Fairbank - Chairman and CEO

Scott Blackley - CFO

Conference Call Participants

Sanjay Sakhrani - KBW

Moshe Orenbuch - Credit Suisse

Betsy Graseck - Morgan Stanley

Eric Wasserstrom - UBS

Don Fandetti - Wells Fargo

Rick Shane - JP Morgan

Kevin Barker - Piper Jaffrey

Brian Hogan - William Blair

Brian Foran - Autonomous

Chris Donat - Sandler O'Neill

Operator

Welcome to the Capital One Third Quarter 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period. [Operator Instructions] Thank you.

I would now like to turn the call over to Mr. Jeff Norris, Senior Vice President of Finance. Sir, you may begin.

Jeff Norris

Thanks very much, Leanne, and welcome everybody to Capital One's 100th quarterly earnings call. As usual, we are webcasting live over the internet. To access the call on the internet, please log on to Capital One's website at capitalone.com, and follow the links from there. In addition to the press release and the financials, we have included a presentation summarizing our third quarter 2019 results.

With me today are Mr. Richard Fairbank, Capital One's Chairman and Chief Executive Officer; and Mr. Scott Blackley, Capital One's Chief Financial Officer. Rich and Scott will walk you through this presentation. To access a copy of the presentation and press release, please go to Capital One's website, click on Investors, then click on Quarterly Earnings Release.

Please note that this presentation may contain forward-looking statements. Information regarding Capital One's financial performance and any forward-looking statements contained in today's discussion and the materials, speak only as of the particular date or dates indicated in the materials. Capital One does not undertake any obligation to update or revise any of this information, whether as a result of new information, future events or otherwise. Numerous factors could cause our actual results to differ materially from those described in forward-looking statements. And for more information on these factors, please see the section titled Forward-looking Information in the earnings release presentation and the Risk Factors section in our Annual and Quarterly Reports, accessible at the Capital One website and filed with the SEC.

With that, I'll turn the call over to Mr. Blackley. Scott?

Scott Blackley

Thanks, Jeff. I'll begin tonight with slide three.

Capital One earned $1.3 billion or $2.69 per share in the third quarter. Net of adjusting items, our EPS in the quarter was $3.32. We had three adjusting items in the quarter, which are outlined on slide 13 of our earnings presentation. There was $212 million or $0.45 per share build in our UK Payment Protection Insurance customer refund reserve in our Credit Card segment, driven by higher-than-expected complaints volume. About $140 of this build was recognized as contra revenue, split across evenly between net and noninterest income, and $72 million was recognized in operating expenses.

The UK regulators previously established a deadline to file PPI complaints, which was August 29, 2019. We received a significantly elevated volume of complaints in the months leading up to the complaint deadline. We are now in the process of determining the eligibility and compensation related to the total complaints.

Next, we had $84 million or $0.14 per share of launch and related integration costs associated with our Walmart partnership in our Domestic Card segment. We continue to expect approximately $225 million of cumulative launch costs with the residual occurring in the fourth quarter.

And finally, we recognized $49 million of charges associated with the cyber incident that we announced at the end of July. These charges were partially offset by an insurance receivable of $27 million, resulting in a net charge of $22 million or $0.04 per share. The timing of recognizing all of the expected insurance reimbursements will lag related charges.

We disclosed last quarter that we expected $100 million to $150 million in certain incremental direct costs associated with the cyber incident response. And then, we expected to record these costs in 2019 and treat them as adjusting items. We now expect to be at the low end of the range, and we expect that some of the adjusting items costs will be incurred in 2020. We continue to expect that a significant portion of these costs will be covered by insurance and that the insurance reimbursements will also be adjusting items. And again, the timing of insurance reimbursements may lag the occurrence of costs.

Beyond the adjusting items, we continue to invest heavily in cyber security, as we have done for years. We expect to make incremental investments in cyber security related to the cyber incident and we expect to absorb the estimated incremental investments within our existing operating efficiency ratio guidance.

Moving to the quarterly results. Relative to a year ago, adjusted pre-provision earnings increased 6% with revenue increasing 4% and non-interest expense growing 3%. Compared to the prior year quarter, provision for credit losses increased 9%, owing to a smaller allowance release and a modest increase in charge-offs.

Let me take a moment to discuss the quarterly movements in allowance across our businesses, which are detailed in table eight of the earnings supplement.

Our card business on allowance release of $64 million were largely driven by stable underlying credit and the strong economy. In our consumer business, there was release of $48 million, which was driven by our auto business. Reserves in our commercial business increased by $33 million, primarily related to syndicated credits in the energy sector.

Turning the slide four. Net interest margin was 6.73% in the quarter, 28 basis points lower than the prior year quarter. Excluding the impact of UK PPI reserve build that I mentioned earlier, net interest margin was 6.81%. The remaining 20 basis points of year-over-year decline was largely driven by higher average deposit costs as we continue to see growth in and mix shift towards our Capital One 360 Deposit products. Going forward, while we continue to keep an eye on interest rates, in the near term, we have a relatively neutral posture to changes in implied forwards.

Turning to slide five, I will cover capital. In the third quarter, we purchased approximately $466 million or 5.3 million common shares of our $2.2 billion 2019 CCAR authorization. Our common equity tier 1 capital ratio on a Basel III standardized basis this quarter was 12.5%. We continue to believe that our long term capital need is around 11% CET1.

Let me take a minute to talk about the factors impacting our capital need. In the 2019 CCAR, the Fed's implementation of a new card loss model created a headwind to our capital under stress. Conversely, the effects of the recently approved tailoring rule will provide a tailwind to our capital reduction under stress. We also believe there is an opportunity for further capital relief under the stress capital buffer framework. So, we continue to keep an eye on the implementation of CECL and CCAR. How and when the Fed implements these new rules in CCAR will be a key factor in when we will be able to manage the CET1 closer to our 11% long-term capital need.

Let me move on to the new allowance accounting standard. We are preparing to adopt CECL on January 1, 2020. We currently estimate that the implementation of the CECL framework will result in a 30% to 40% increase in our corporate allowance, largely driven by our consumer businesses. As a result, we believe that the impact of adopting CECL, which is phase in over four years, will reduce our 2020 CET1 ratio by 13 basis points to 18 basis points.

I'd like to take a moment to discuss movements in our preferred stock levels. In September, we issued $1.5 billion of Series I preferred stock, which has a 5% dividend that is paid quarterly, subject to Board approval. Additionally, we will redeem our outstanding preferred Series C and D in December, resulting in a one-time charge that will reduce net income available to common shareholders by approximately $30 million. The replacement of Series C and Series D with Series I, will save approximately $15 million per year in ongoing preferred dividend expense.

With that I'll turn the call over to Rich. Rich?

Richard Fairbank

Thanks, Scott. I'll begin on slide eight, which summarizes third quarter results for our credit card business.

Pretax income for the quarter was $969 million, including the $212 million UK PPI reserve build that's Scott discussed. Beyond the PPI impact, Credit Card segment results and trends are largely driven by the performance of our Domestic Card business, which is shown on slide nine.

Domestic Card ending loan balances increased by $3.1 billion, or about 3%, compared to the third quarter of last year. Average loans were also up 3%. The growth of Branded Card loans, which exclude private label and co-Branded Cards, continued to accelerate. In the third quarter, Branded Card loans grew 5.7% from the prior year quarter. We posted another quarter of strong purchase volume growth as we continue to grow our heavy spender franchise. Year-over-year, Domestic Card purchase volume growth was 11%. Normalized for two additional processing days in the third quarter of 2019, year-over-year purchase volume growth was about 9%. Net interchange revenue for the total Company grew 11%.

Revenue increased 2% from the third quarter of 2018. Noninterest expense was up 10%. About half of the increase in the noninterest expense was driven by the Walmart adjusting items Scott discussed, as well as some run rate Walmart operating expenses in the quarter. Beyond the Walmart impact, other drivers include continuing technology investments and normal quarterly variability.

Domestic Card credit performance remained stable. The charge-off rate for the quarter was 4.12%, a 23 basis-point improvement year-over-year. The actual improvement was about 10-basis-point, when normalized for the impact of the accelerated recognition of a state charge-off, which added 13 basis points to the charge-off rate in the third quarter a year ago. The 30 plus delinquency rate was 3.71%, down 9 basis points from the prior year quarter.

Pulling up, in the third quarter, our Domestic Card business continued to deliver strong results and gain momentum.

Before moving on to Consumer Banking, I'll briefly discuss the Walmart partnership. On September 24th, we launched the new Walmart co-brand and private label cards and on October 11th we completed the acquisition of the existing Walmart card portfolio. We on-boarded $8.1 billion in loans. We estimate our initial allowance build to be approximately $85 million, which will be a part of our fourth quarter allowance. We are excited to partner with the world's largest retailer to deliver compelling products and a great digitally enabled customer experience to Walmart customers.

Other than the adjusting item that Scott discussed, the Walmart partnership did not meaningfully affect third quarter results. Like other card partnerships, we will include Walmart program results as a part of our overall Domestic Card business, rather than break them out separately.

Driven by the revenue and loss sharing provisions, we expect that the acquired Walmart portfolio will affect several Domestic Card metrics. We estimate that the acquired portfolio will reduce the Domestic Card charge-off rate by about 25 basis points in the fourth quarter of 2019 and reduce full-year 2020 charge-off rate by a similar amount with some quarterly variability. We estimate that the acquired portfolio will reduce the Domestic Card revenue margin by about 35 basis points in the fourth quarter, about 50 basis points in the first three quarters of 2020, and after the revenue share on the acquired portfolio steps up in October of next year, about 35 basis points in the fourth quarter of 2020. We expect the charge-off rate and revenue margin impacts to diminish over time as the acquired portfolio runs off.

Delinquency metrics are not affected by the loss sharing agreement. We estimate that the existing Walmart portfolio will increase Domestic Card delinquency rate by about 25 basis points at the end of the fourth quarter and by about 15 basis points at the end of 2020.

Slide 10 summarizes third quarter results for our Consumer Banking business. Ending loans increased about 5% compared to the prior year quarter. Average loans grew 3%. In a marketplace with increasing competitive intensity, our auto business delivered strong year-over-year originations growth and a modest acceleration of loan growth, along with stable credit results and a modest pickup in loan yields. Digital innovation is the key driver of our increasing momentum in the auto business.

Ending deposits in the Consumer Bank were up 5% versus the prior year quarter with a 31 basis-point increase in average deposit interest rate. The sequential quarter increase in deposit interest rate was 5 basis points. Both increases were primarily driven by deposit mix. Powered by the rollout of our national banking strategy, our deposit growth has been in Capital One 360 products, which has resulted in a product mix shift toward higher rate deposit products. While we expect this mix shift to continue, our average deposit rate going forward will depend on several factors, including the market interest rate environment, our deposit mix and competitive dynamics.

Consumer Banking revenue increased about 3% from the third quarter of last year. Noninterest expense was up less than 1%. Third quarter provision for credit losses increased $19 million year-over-year, primarily because of a smaller allowance release in the third quarter of this year, compared to the allowance release in the third quarter last year.

The auto charge-off rate improved 13 basis points, compared to the prior year quarter to 1.60%. Better-than-expected auction values and a benign economy continue to support strong auto credit. We continue to expect that the annual auto charge-off rate will increase gradually as the cycle plays out.

Moving to slide 11, I'll discuss our Commercial Banking business. Third quarter ending loan balances were up 7% year-over-year, growth in average loans was also 7%. Our growth is concentrated in select industry segments with lower risk, lower margin and the potential to generate fee income over time.

Commercial Bank ending and average deposits were both relatively flat, compared to the prior year. Third quarter revenue was up 1% from the prior year quarter. The revenue benefit of higher average loan balances was offset by lower loan margins. Noninterest expense was also up 1%, compared to the prior year quarter. Provision for credit losses increased, compared to the third quarter of 2018, largely driven by weaknesses in our energy portfolio. About two-thirds of the increase was from higher charge-offs, and as Scott discussed, we also built allowance in our Commercial Banking business.

Outside of the energy portfolio, Commercial Banking credit performance remained strong. The charge-off rate for the quarter was 0.33% and criticized loan rates were relatively stable, compared to both the prior year and sequential quarters. The criticized performing loan rate for the third quarter was 2.8% and the criticized nonperforming loan rate was 0.6%.

Pulling up, we're keeping a watchful eye on market conditions. Unregulated competitors continue to put pressure on pricing, loan spreads and loan terms for non-banks and banks alike. Against that backdrop, we're carefully choosing our spots and staying disciplined in our underwriting and origination choices.

Pulling up on the third quarter, Capital One continued to post solid results as we continue to invest to grow and drive our digital transformation. Our marketing and technology investments are building our momentum and creating great value. Our Domestic Card business delivered strong year-over-year growth in purchase volume and Branded Card loans. In our Consumer Banking business, our national advertising, brand and compelling digital customer experience enabled us to post strong year-over-year growth in retail deposits. With the momentum we have in Domestic Cards and retail deposits, we continue to expect full-year marketing for 2019 to be modestly higher than in full-year 2018.

Looking at quarterly trends. Third quarter marketing was flat year-over-year and down slightly sequentially, but that was essentially a timing issue with some planned third quarter marketing shifting to the fourth quarter. We remain all-in on our technology transformation, and our progress continues to accelerate. We continue to expect that we'll complete the exit of our data centers by the end of 2020, which should generate significant cost and efficiency improvements, beginning in 20201. Until then, we'll continue to drive for operating efficiency improvement, even with the elevated costs of straddling both the data center and cloud environments.

While the market interest rate environment creates an efficiency headwind for most banks, including Capital One, we still expect to achieve modest improvements in full-year operating efficiency ratio net of adjustments in both 2019 and 2020 with a bigger move down to 42% in 2021. We expect the improvement in 2021 to be aided by the impacts of our datacenter exit and growth in the Walmart partnership revenue, both of which show up in late 2020, as well as continuing technology innovation. And we expect this operating efficiency improvement to drive significant improvement in total efficiency ratio by 2021 as well.

As the many benefits from our technology transformation continue and increase, we are well positioned to succeed in a rapidly changing marketplace and create long-term shareholder value.

Now, Scott and I will be happy to answer your questions.

Jeff Norris

Thank you, Rich. We'll now start the Q&A session. As a courtesy to other investors and analysts who may wish to ask a question, please limit yourselves to one question plus a single follow-up. If you have any follow-up questions after the Q&A session, the Investor Relations team will be available after the call. Leanne, please start the Q&A.

Question-and-Answer Session

Operator

Thank you. [Operator instructions] And our first question today will come from Sanjay Sakhrani with KBW.

Sanjay Sakhrani

Thanks. Scott, I was hoping to get a little bit more clarity on the NIM expectations going forward. I heard you said you were sort of rate neutral as rates are going down. But, then, you've got like the move to 360 and then Walmart. So, as we think through future rate cuts and obviously these moving factors, could you just give us some dimensions on how to think about the NIM migration? And then, I'll ask my second one upfront. Rich, I know Scott talked about this at a conference, but I just wanted to get your perspective on the cyber security incident. I know there's been some questions on the cloud migration as a result of it. And I was just wondering if you could just give us your updated views? Thanks.

Scott Blackley

All right, Sanjay. Well, I'll start off on NIM. So, as I think about where NIM might be headed, I got a few thoughts for you. The first is that we've seen deposit rates and mix that have been creating the headwind -- those have been creating the headwind to NIM, since really late last year. Now, those deposits are a great source of stable funding for the Bank, and we're really happy to have them. More recently though, we've been seeing some easing in NIM headwinds from rates and even a bit on mix. So, on the liability side, while we've seen some headwinds, starting to see some signs that those are abating a little bit.

And then, on the asset side, Walmart is modestly positive to NIM. Card and auto are growing at attractive rates. And so, on the asset side, we're certainly seeing some momentum on that end. And then, when you talk about just rates in general, as you mentioned, we have a modest near-term exposure to movements in implied forwards. So, in the near-term, I think that rates aren't going to be a big driver. So, when I pull up and I look at all the different forces that are impacting NIM from both directions, it doesn't look to me that any of them are particularly outsized compared to the others.

Richard Fairbank

Sanjay, with respect to the public cloud, and then the cyber incident, while the event occurred in the cloud, the vulnerability that led to our breach is not specific to the cloud, and could have happened in on-premises data center environment. We remain absolutely committed to our digital strategy and our technology transformation, and the public cloud is an essential element of that strategy. I mean, the benefits of the cloud are pretty comprehensive, including agility, innovation, resiliency, security and cost benefits. And in fact, we believe our tech transformation and our move to the cloud in particular, provided some important benefits in this cyber situation. For example, as part of the cloud journey, we were able to tokenize critical data at scale. Also, the cloud was essential to our being able to quickly diagnose and respond to the incident. So, naturally as -- with an event like this, we're pouring a lot of energy into make sure we get all the learnings and harnessing the energy from an experience like that to really further strengthen cybersecurity and our capabilities broadly across the board. But, we are reminded even through this event of the benefits and power of the public cloud.

Jeff Norris

Next question, please?

Operator

And our next question comes from Moshe Orenbuch with Credit Suisse.

Moshe Orenbuch

So, I guess, Scott, I was sort of hoping you could expand a little bit on the deposit pressures that you saw abating on the Consumer Bank, I think they were still kind of going up in the third quarter, albeit, I guess, at lower rate than in Q2. But, like, what areas you're seeing and what might we see in the balance of the year and into early 2020?

Scott Blackley

Moshe, well, we've seen -- when I look at the competitive landscape, we've seen a number of competitors who've been lowering rates, we've had some of our products with lowering rates. And so, we're starting to see deposits being more responsive to rates going down. And with that we're seeing a little bit of a reduction to the headwinds that we have been experiencing on NIM.

Moshe Orenbuch

Got you. Just as a follow-up, Rich, you highlighted the acceleration on the credit card balance front. Maybe just kind of give us a little more color there. Obviously the consumer -- this has still kind of continued to grow, but how are you seeing that in terms of balancing growth and risk?

Richard Fairbank

Yes. So, in our Branded Card business, we separated that out just because that number was quite a bit different from the overall kind of Domestic Card number, but it's a reflection of the continued traction that we're getting across the board. And I think, it's -- the continuing success we're having in marketing, the traction we're having at the top of the marketplace in our spender business, but also we continue to have traction really across the board. That traction is coming from continued strong origination of accounts but also continuing to lean in a little bit more each quarter on the credit line just as we continue to validate by looking in the -- at the performance of recent vintages and continue with an eye on the economy. All of that is contributing to some acceleration on the Branded Card growth.

With respect to the consumer, how do we feel about that? I think, the U.S. economy and the U.S. consumer is in pretty good shape. Consumers are obviously benefiting from strong labor market, rising wages, and last year's tax cuts, all of which are driving up disposable incomes. The savings rate is solid, the rate of borrowing is reasonable, debt servicing burdens are stable and well below the levels that we saw before the great recession. Retail sales growth is down a bit from a year ago but still solid.

When we look inside our portfolio, we see that delinquencies and charge-off rates are low, payment rates are -- continue to sort of gradually rise. And that is sort of the flip side of or another manifestation of credit strength and the confidence and strength of the consumer. One metric we watch as a leading indicator is the proportion of customers who are paying only the minimum payment on their cards and over the past year, that metric has been stable to slightly improving.

Now, of course, the consumer is a resident in our broader economy and not only the U.S. but the world economy, and implications of things like growing government deficit, trade related issues, and the intense political environment are something we certainly keep an eye on.

There is also pockets within lending that we are watching, such as installment loans. Installment loans are growing at 15%, and some lenders are not reporting to the credit bureaus. So, I'm not sure that we actually know the size of that number, but we know it's pretty bank, and that can have -- we're not in the installment loan business, but we can be affected by those things, so. And most importantly, it's not loss on us, we're deep into the economic cycle, and we underwrite with the focus on resilience. And if you pull way up what that means is, while still being very obsessive about those, about the risks out there, we continue to see an opportunity to grow our business, we see stability in the consumer and on the credit side, and that augurs well for continued opportunity in card.

Jeff Norris

Next question, please?

Operator

And our next question comes from Betsy Graseck with Morgan Stanley.

Betsy Graseck

I just wanted to dig in a little bit on the outlook comments that you gave you around the back book Walmart portfolio and wanted to understand how you are thinking about the K rate of $8.1 billion, over how many years we should expect that to take? And then, the second thing was, I know you gave a lot of color on the NCS delinquencies and the revenue margin. How do you see that trajecting in that 13, 14 months because you have difference set up, right, economically with Walmart than the first 12 to 13 months and month 13 on, maybe you could go through your broader outlook as well. Thanks.

Richard Fairbank

Okay. So, Betsy, the Walmart -- all of our guidance about how the metrics were going to be affected is, I want to stress, as you indicated, it's about the portfolio that we bought from Walmart. We of course also are originating business with Walmart, but that's much more of a kind of business as usual thing, and the impact on the metrics will be much more in the business as usual category. This portfolio stands out for a number of reasons. I mean, it's all at one moment; it arrives on our balance sheet. So, we want to deflate what happens with the metrics. This is also a portfolio with a significant loss share as well as a revenue share, and it has some pretty striking impacts on some of the metrics that we outlined.

It is a portfolio that historically has had a -- the runoff rate, the attrition rate starts with the pretty high charge-off rate that we talk about in that. And then, of course there is natural attrition as well. So, we are inheriting a portfolio that runs off reasonably quickly, if you isolate it from new originations, which we are here with this guidance. The one thing that makes it kind of hard to predict how fast the attrition will go is that this value proposition, including 5% on walmart.com, 2% off on everything bought in the store, this is a significant improvement in the value proposition relative to what the customers had before. And we are giving that to all existing customers of this portfolio.

So, hopefully that will help on the nutrition side. We don’t have any data on that. But, what we wanted to stress is that the impact on our metrics will happen all at once, like we talked about. And then, we should we should all assume a run-off, a gradual run-off of that driven especially by the fairly high charge-off rate.

The only other event of note is the step-up in the revenue share that happens with respect to this portfolio starting in October of 2020. So, that’s a single event, and we will be the beneficiary of a higher revenue share, same loss year, but a higher revenue share and that will continue over the life of the portfolio. That’s why we gave our guidance in a series of steps.

The only other thing that I wanted to just savor, the delinquency -- I know everybody looks with -- understandably with a magnifying glass at delinquency and credit -- and charge-off numbers, and it’s really important to us that we were able to talk about the differential impacts that come from that back book. The charge-off numbers will be net charge-off numbers because we are reporting only the charge-offs for our loss share portion of the total charge-offs. The delinquencies, we -- this on our balance sheet, so, we have the entire -- the delinquencies, we will report in their entirety, even though an important portion of the losses will be taken by Walmart. So, that’s why particularly on the delinquency side, there will be some striking impacts that we wanted to flag.

Jeff Norris

Next question, please?

Operator

And we’ll take our next question from Eric Wasserstrom with UBS.

Eric Wasserstrom

Just one quick clarification and then I have a real question. Just on the PPI, given the August deadline has now passed, is this the end of the builder or could this -- could you see incremental building into the fourth quarter?

Scott Blackley

So, as I outlined in my prepared remarks, the deadline was, as you mentioned, August 29, 2019, and we've now passed that PPI deadline. So, we now know the total volume of complaints that we can receive. What we're doing right now is going through all those complaints and trying to determine which of them are valid complaints and what the appropriate level of compensation is on those complaints. That process, given the elevated level of claims that we incurred, is going to take around six months to complete. The reserve that we built on in this quarter, we included an estimate of how many of those claims we thought would be valid and the portion of compensation that we would have to pay. We did that based on kind of our history of what we've seen. It stands to reason that when you have a spike in claims right before a deadline, you may not have as many claims that are valid as you've seen over a long history. But, we didn't take that into account. So, we feel, at this point, well-reserved for everything we know, and we're not going to be getting any claims.

Eric Wasserstrom

Great. That's very clear. Thank you. And then, my real question is about the marketing spend. It was about a year ago that, Rich, you signaled that you're entering this investment cycle. And, I would just love to get an update on how you're feeling about the efficacy of that spend at this point and sort of what the short to medium term outlook might be as we look to the New Year?

Richard Fairbank

Eric, it continues to be a very positive story for us. We -- in card, the marketing is strengthening our heavy spender franchise, it's driving strong growth in new accounts, purchase volume, net interchange revenue, and now increasingly loans as well. On the bank side, the increased marketing is really basically the tip of the spear of our organically building a national bank. And that's fueling deposit growth and also moving a lot of the sort of metrics associated with cafes and our brand on the national banking side. In fact, speaking of brand, this is one of the big beneficiaries overall of the marketing that we're doing. We're seeing a lot of traction across the Company and our brand metrics in hard to move brand equities that really are critical to building a franchise.

So, we continue to be enthusiastic as we have been for a number of months. One thing that's just a little different versus a year ago, we had such a big step up because we were launching a couple of new programs. But, we don't have that at this very moment, new launches, but except of course, Walmart here. But we continue to be bullish. And in fact, now that I mentioned Walmart, we will be sharing with Walmart a pretty active and positive campaign associated with this card. And, again, we will be underwriting a portion of that.

Jeff Norris

Next question, please?

Operator

And we'll take our next question from Don Fandetti with Wells Fargo.

Don Fandetti

Question on CECL. It's interesting with all the talk about the impacts over the last year. So, really the increase isn't too bad for you, not that dissimilar actually from Amex. And I was just wondering if you could talk about some of the offsets, I guess, maybe on your commercial side of your portfolio? And then, Scott, is it fair to say there's only a pretty modest impact downward biased in terms of the impact to GAAP 2020 CECL and without CECL?

Richard Fairbank

Yes. Let me just start off kind of talking about the longer term impacts of CECL. So, obviously, CECL creates a onetime reduction in our capital ratios that adoption, and it's permanently increasing the amount of capital that we'll hold against those losses. In terms of future allowance builds, I think, in times of slow and stable growth, a stable economic outlook, I'd expect that CECL is going to look fairly similar to what we see with allowance moves today. I don't think that we'll see a lot of violence then. However, I think when you see periods of accelerated growth, significant changes in the economic outlook, I feel confident that we're going to see amplified allowance moves and increased provision volatility. So, when I pull up, I think, it's completely appropriate just to mention that CECL is not going to change the way that we approach our businesses and how we conduct the business of lending.

I kind of look back at the fact that, we don't yet know how the Fed will incorporate CECL and the CCAR, that's still a few years away. Ultimately that could impact capital levels for us and for all banks.

And the other thing I'd say is, as we've been saying, I think in periods of stress, in a deep recession, I continue to be worried that CECL will make it more difficult for the banking industry to lend, when you have to record lifetime expected losses before you get to report any of the related revenue. And so, you know I'm anxious about that.

And then, Don, to your other question about the puts and takes, it's really difficult to unpack other banks' CECL disclosures. I don't really have good insights to what's driving their CECL numbers. I can tell you that our 30% to 40% estimate of the increase in allowance and adoption represents our balance sheet mix, the business practices that we follow and the accounting policy elections that we've made. And in order of magnitude, on the initial adoption of CECL from lowest to highest, commercial is the lowest, card is the second, and then auto is third. And that's in terms of magnitude of the allowance build from lowest to highest.

Don Fandetti

Okay. And then, one last on shifting to auto, how are origination yields? Are they holding up pretty well? It looks like yields are coming in obviously still above the portfolio yield. And have you seen any shift in competition? It looks like your subprime mix continues to go up a tiny bit in auto.

Richard Fairbank

Yes. So, the auto -- the competitive environment is -- continues to be -- it's pretty intense, but it still offers I think quite a bit of opportunity. Let me talk about the parts of the marketplace. In subprime auto, we've seen a rapid growth actually of small independent lenders, although they are more focused on deep subprime, high-loss business. We also see some increased competition from some lenders who had previously pulled back. And we remain vigilant on that, but definitely the subprime opportunity is there.

In near-prime, the competition from some who had pulled back in the past, certainly has intensified quite a bit. We still see opportunity, but it's definitely intense, the competition there. And in the prime market, we have seen some reversal in the trend of increasing market share of credit unions, although the market continues to be competitive.

When we look at margins in general, the margins have -- are actually pretty healthy, and even a little healthier in prime than they have been in some past periods. So, we continue to see a growth opportunity. I would just also say that while we don't have any way to quantify this, I think, we have been benefited by the technology investments that we have made in the business. Investments on the underwriting side, the sort of real time -- creating real time underwriting and real time pricing capabilities that are enabled by our cloud strategy and our overall technology transformation, in product design, in sort of things to help dealers and things to make our operation be just so much more effective in real time. And all of these are things we've worked hard to create. I think, they're very beneficial. They don't transcend the competitive and cycle conditions that will still dominate our metrics. But, I think underneath it all, there's a growing strength that we have in the auto business and just one of the many benefits that is growing related to our tech transformation.

Jeff Norris

Next question, please?

Operator

And our next question will come from Rick Shane with JP Morgan.

Rick Shane

Hey, guys. Thanks for taking my question. I was actually a little worried I wouldn't get to participate on the 100th call. Congratulations. It's really quite an achievement. Just one clarification. Scott, you've talked about the CECL reserve, and I just want to make sure that we all understand that in the context of the Walmart acquisition. Should we think of that 30% to 40% increase not as versus September 30th but a day zero to day one change?

Richard Fairbank

Yes. You should think of that as our estimate for the January 1, 2020 adoption, which would include all of the assets that are on balance sheet as of that date. So, Walmart would be included in that as with all of the other assets at that point.

Rick Shane

Okay. Most of the companies we follow talked about in the context of September 30th. I just wanted to make sure, given the sizable acquisition, we're thinking about that in the right way. That's it for me…

Richard Fairbank

We've tried to make an estimate for the total impact of the Company, given kind of where we are and where we would expect to be.

Jeff Norris

Next question, please?

Operator

And our next question comes from Kevin Barker with Piper Jaffrey.

Kevin Barker

Just to follow up on some of the comments around NIM, and some of your -- the explanation you gave going forward use. Could you help understand where you see the trajectory of the securities portfolio, especially with a little bit of stabilization at 10-year that we've seen recently?

Richard Fairbank

Yes. Just a few thoughts there. So, NIM in the quarter was pretty modestly impacted by the fact that we were holding some additional cash on Walmart in preparation for acquiring the Walmart portfolio. So, we will be -- as we go ahead and have executed that will be replacing that with the higher yielding assets of the Walmart portfolio. So, that's going to be a net positive in terms of the trajectory of NIM.

In terms of the securities portfolio, it's been trending down a little bit which is mainly a liquidity assessment terms of what we need for liquidity in that portfolio. I don't think there's going to be a significant change to NIM in terms of what we see coming out of that portfolio.

Kevin Barker

Okay. Was there any outsized amount of premium amortization this quarter? And, could you give us an idea of where your new money yields are on the securities portfolio?

Richard Fairbank

I don't think that in terms of -- I don't think, there's really anything meaningful in any of those areas for me to share with you in terms of the impact on the quarter, going forward.

Jeff Norris

Next question, please?

Operator

And our next question comes from Brian Hogan with William Blair.

Brian Hogan

Thank you. My first question is actually on the growth of your employee base. So, it's been accelerating, and it was up 9.5% year-over-year. And I guess, I mean, in conjunction with your shift to technology and focus on that digital transformation. So, I guess, why the significant growth in personnel, what are they doing? What are your investments in that?

Scott Blackley

Hey, Brian, it's Scott. I think the thing that's probably most impactful right now on headcount is that we're ramping up for the Walmart launch and integration. We started doing that a couple quarters ago. That's really been the largest growth in headcount most recently. And as you mentioned that our technology investments in work there have been over time than adding to total headcount. But, I think just in general, the growth of the Company and Walmart have been a major factor as well.

Brian Hogan

Should we expect that to level off that, right?

Scott Blackley

Well, in terms of the Walmart personnel, that's a group that we have brought on to deal with that account. So, I would expect that we wouldn't have further increases in headcount associated with Walmart, and then the rest of kind of the trajectory there is going to be driven by normal business activity.

Richard Fairbank

Brian, but to your point, the 42 by 21, a 1aenabler of that. And in fact, without this, we wouldn't be same 42 by 21. A central enabler of this is the benefits that have come from our heavy all-in tech transformation where we are approaching the end of the seventh year of our tech transformation. And, for much of that transformation, it costs more before it costs less. And we continue to invest and we will invest on a continuing basis. Because, I think increasingly, technology is what a sort of tech company does. But that said, our confidence to shingle ourselves as far in advances did to some pretty bold efficiency ratio target is powered by efficiencies that come from the tech investments and cost saving -- on the cost saving opportunities from changing how we work, driving customers to digital, driving really the company to digital, driving down technology costs themselves as we move away from a lot of expensive proprietary technology as we consolidate our technology, reduce a lot of duplication and really moved to just a better way of operating. So, just wanted to mention that.

Jeff Norris

Next question, please?

Operator

And our next question will be from Brian Foran with Autonomous.

Brian Foran

Hi. I mean, you've addressed a lot already. I mean, maybe -- I guess, I'm only struck by people are always focused on your overall tone on this conference calls. And if I just kind of go down the things that matter, I mean, since like you are feeling a little better about some of the leading indicators on credit, a little better online size increases and thus branded card growth, little less worries on the interest rates, still confident on the OpEx. And maybe I'm over-reading it, but it felt like maybe the excess capital position was becoming a little bit clearer, less uncertainty there. I mean, is it fair, if someone just asks, was Capital One more or less positive? I mean, it sounds like you are a little bit more positive on all the key fronts. Is that a fair assessment or are there some negatives that maybe I'm leaving out?

Richard Fairbank

Brian, I think, I was writing it down as you were doing it, going over credit, and yes, the line increases. I mean, again, we're still in the overall motive of cautious where we're in the economy, but line increases, check. I would add continuing bullishness about the marketing and the success, the traction in the card business overall. Interest rates, now again, on interest rates, it's hard to be bullish on that. But, we are -- relative to the some of the seismic impacts that have happened in interest rates, I think the combination of how the market's responding and the tools that we have in our portfolio to adapt, I think, we have increasing bullishness about that.

Operating expenses, if you pull up the kind of -- our point was that we got delta curve ball that wasn't in our plans, when we announced the 42x21. I remember the meeting when we first -- somebody brought in, well, this is going to be the impact, the sort of gross impact of this on what could be with respect to revenues on interest rates. And after we caught our breath, we continued to just work incredibly hard and the traction on operating expenses and all matters around the efficiency ratio continues to be positive such that despite the interest rate move, we are continuing to reaffirm our guidance of the capital. There is a strong excess capital thing position there.

And the other one I would add on the list is the continued -- you can feel it inside the Company. It's hard for the outside world to see this, partly because we don't always proclaim some of the things that are proprietary that we're doing. But, the tech transformation that started at the bottom of the technology stack, a place that is the hardest work, shows the least immediate payoff. And in fact if you selectively transform yourself in the bottom of the technology stack, it doesn't really do much for you. But I've said over the years, and in the end, I know really the proof ultimately is in the pudding and what investors see.

But, what I want to say is it's a very the unusual thing that Capital One has done by so heavily starting at the bottom of the tech stack and working up. I think, most companies when they do the tech transformation start at the top of the tech stack, meaning innovating on the part of the technology that is customer or associate facing. And it's very natural thing to do because that's by definition the only thing that people can see and that's where competitors put pressure, customers are clamoring, et cetera. But, we have been transforming from the bottom of the technology stack.

But as we continue to move up the tech stack, more and more will be visible over time, the benefits will become greater, the agility greater and the opportunity to create great things at the top of the tech stack, the ability to transform how we work, the ability to make some significant differentiated capabilities on the risk management side, and ultimately to create a great customer experience and better and better economics. That is what we've been driving for, for years. And I think we continue to have a bullishness about that. So, what's the yikers is along the way is just a lot of work. There are a lot of things that happen on the way to work but this is we continue to feel an increase in momentum on these things that are long time in the making, but I think, they are at the heart of winning in the very different place where the world is going.

Jeff Norris

Next question, please?

Operator

And our final question this evening comes from Chris Donat with Sandler O'Neill.

Chris Donat

I just want to ask about the pricing strategy for Capital One 360 in an environment where you have seen some of the large,, call them cyber deposit gatherers decrease their rates. How do you feel about strategy in terms of both, competitors and in terms of Fed funds and other benchmarks as far as -- what factors really determine where you set that deposit rate?

Richard Fairbank

Well, Chris, it would be a fairly straightforward thing. I wouldn't know. I'd never use the word easy but it would be a fairly straightforward thing to build a direct bank that goes to the top of bank rate monitor and builds deposits that way. And what -- that's not the business that we have wanted to build. And the term I always use is we want to build a franchise. And that's a much higher calling. And, there's a lot that goes into that. But, one of the benefits over time of building a franchise is one doesn't have to chase rates at the top of the marketplace, but rather is providing really good deals for people who believe in the Company and where we can have enduring relationships. And that's what this has been about.

So, with every passing year, we partly measure our success by how far we're able to distance ourselves from just the very -- the players who are just absolutely chasing race at the top of the rate table. And that's not only an economic benefit, but it actually really helps in terms of the kind of customers that we're attracting, the selection dynamics that are critical in terms of the longevity of the deposits themselves. So, we have -- so that sort of the already the state of mind and where we have been. As now a new thing comes along which is the bottom falls out of the interest rate marketplace. We have noticed a number of players on the direct space moved. We also lowered our price at the end of the quarter. And we will continue to watch the marketplace. But we certainly -- our strategy is not to chase the hot money. Our strategy is really to provide great deals to consumers and have the streamlined economics and the digital model to support that. And that's what we will continue to do. And that -- I think it will serve us well through this part of the cycle and I think over the longer term.

Jeff Norris

Well, that concludes our question-and-answer period and our call for this evening. Thank you for joining us on this conference call today and for your continuing interest in Capital One. As a reminder, the Investor Relations team will be here this evening, if you have further questions. Thanks, everyone. Have a great evening.

End of Q&A

Operator

And that does conclude today's conference. Thank you for your participation. You may now disconnect.