Wells Fargo & Company (WFC) on Q3 2019 Results - Earnings Call Transcript

Oct. 15, 2019 1:54 PM ET | 6 Likes
by: SA Transcripts

Q3: 10-15-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $1.07 misses by $-0.10 | Revenue of $22.01B (0.31% Y/Y) beats by $816.33M

Earning Call Audio

Subscribers Only

0:00 / 1:08:34

Wells Fargo & Company (NYSE:WFC) Q3 2019 Earnings Conference Call October 15, 2019 11:00 AM ET

Company Participants

John Campbell - Director, IR

Allen Parker - Interim CEO and President

John Shrewsberry - CFO

Conference Call Participants

Erika Najarian - Bank of America Merrill Lynch

Scott Siefers - Sandler O'Neill

John McDonald - Autonomous Research

Ken Usdin - Jefferies

John Pancari - Evercore ISI

Matt O'Connor - Deutsche Bank

David Long - Raymond James

Vivek Juneja - JPMorgan

Eric Compton - Morningstar

Saul Martinez - UBS

Betsy Graseck - Morgan Stanley

Operator

Good morning. My name is Regina, and I will be your conference operator today. At this time, I would like to welcome everyone to the Wells Fargo Third Quarter 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 session. [Operator Instructions] Thank you.

I would now like to turn the call over to John Campbell, Director of Investor Relations. Sir, you may begin the conference.

John Campbell

Thank you, Regina. Good morning, everyone. Thank you for joining our call today where our Interim CEO and President, Allen Parker; and our CFO, John Shrewsberry will discuss third quarter results and answer your questions. This call is being recorded.

Before we get started, I would like to remind you that our third quarter earnings release and quarterly supplement are available on our Web site at wellsfargo.com. I'd also like to caution you that we may make forward-looking statements during today's call that are subject to risks and uncertainties. Factors that may cause the actual results to differ materially from expectations are detailed in our SEC filings including the Form 8-K filed today containing our earnings release and quarterly supplement.

Information about any non-GAAP financial measures referenced, including a reconciliation of those measures to GAAP measures, can also be found in our SEC filings, in the earnings release, and in the quarterly supplement available on our Web site.

I will now turn the call over to Allen Parker.

Allen Parker

Thank you, John. Good morning, everyone, and thanks for joining us for today's discussion of our third quarter results. Our earnings included a number of significant items that John Shrewsberry will discuss, but I'll note at the outset that our underlying business fundamentals were strong. That strength was demonstrated by, among other things, increases in loan and deposit balances both from the second quarter and from a year ago, our highest branch customer experience scores in over three years, and continued growth in primary consumer checking customers.

As you all know, Charlie Scharf will join Wells Fargo next week as our new CEO and President. I've had the opportunity to spend a great deal of time with Charlie, and I'm convinced that he has the right combination of experience, business savvy, and leadership ability to position Wells Fargo for an even more successful future. I look forward to working with Charlie on a seamless transition as he assumes his responsibilities as CEO, and I return to my role as the company's General Counsel. It's been an honor for me to serve as our Interim CEO and President over the last six months. I am proud that during my time in this role, the company continued to move forward, and we made progress on our top priorities, which include focusing on our customers and team members, meeting the expectations of our regulators, and continuing our company's important transformation.

Let me provide just a few examples of our most recent progress. In the area of leadership, we made important hires during the third quarter in Technology, Merchant Services, and Wealth Management. In addition, within Consumer Banking, we named leaders to new roles that will help us better serve our customers. David Kowach, who was most recently the head of Wells Fargo Advisors, assumed a new role as the Head of Community Banking, reporting to Mary Mack. We created this role because we believe that having a single dedicated leader supporting our team members and customers in our branches will significantly further our ongoing transformation.

We also formed within Consumer Banking, a new Enterprise Customer Excellence Group that will, over time bring together functions from across the company and give us broader insight into the customer experience. This new group is under the leadership of Andy Rowe, who led Consumer Segments and Consumer Strategy for the last two years. And in the area of innovation and technology, we made several important announcements during the third quarter. Wells Fargo's ongoing commitment to exploring and investing in emerging technologies through the Wells Fargo Startup Accelerator program was demonstrated by our adding two new companies, one focused on augmented reality and the other focused on climate change risk. The total number of companies in that portfolio is now 25.

We also announced plans to pilot, next year, Wells Fargo Digital Cash, which is designed to enable us to complete internal booked transfers of cross-border payments running on our first distributed ledger technology platform. This new technology should drive operational efficiencies by providing longer operating windows and real-time processing. Finally, we announced a data exchange agreement with Plaid, a leading data platform. With this agreement, our customers will have greater control over the bank account information they share with Plaid-supported apps, including the ability to turn on or off data sharing through Wells Fargo's Control Tower.

I want to conclude my comments this morning by thanking the members of our operating committee, our other senior leaders, and all our team members for their efforts, dedication, and perseverance during the last six months. In particular, I want to thank Doug Edwards for his strong and thoughtful leadership as our Interim General Counsel during this period of transition. We continue to have a lot of work ahead of us, but the unwavering focus of our team members on serving our customers are also working tirelessly to transform Wells Fargo has enabled us to make substantial progress toward our goals over the last six months.

Looking forward, I am confident that the extraordinary strings of the Wells Fargo franchise, when combined with our new leadership and our collective commitment to work hard to achieve further improvements will result in a company that is well-positioned to benefit our shareholders and all our other stakeholders.

John will now discuss our financial results in more detail.

John Shrewsberry

Thank you, Allen, and good morning everyone. We had a number of significant items in the third quarter that impacted our results, which we highlight in slide two. We had $1.9 billion of operating losses, predominantly reflecting litigation accruals for a variety of matters, including a $1.6 billion discrete litigation accrual for previously disclosed retail sales practices matters that was not tax deductible and reduced EPS by $0.35 per share. We had a $1.1 billion gain from the sale of our Institutional Retirement and Trust business, which contributed $0.20 per share to EPS. We had gains of $302 million from the sales of $510 million of Pick-a-Pay PCI, and other PCI residential mortgage loans.

We had $244 million in mortgage servicing rights valuation adjustments driven predominantly by higher prepayment rate estimates on our MSRs. These valuation adjustments resulted in our mortgage banking revenue declining from the second quarter despite an increase in mortgage originations and higher production margins. We had a

$105 million impairment of capitalized software reflecting reevaluation of software under development. We also had a modest $50 million reserve build compared with the $150 million reserve release last quarter.

Finally, we partially redeemed our Series K Preferred Stock, which reduced diluted EPS by $0.05 per share as a result of elimination of purchase accounting discount recorded on these shares at the time of the Wachovia acquisition. This partial redemption will reduce the amount of our quarterly preferred stock dividends by approximately $23 million, starting in the fourth quarter. While our financial results in the third quarter were impacted by these items, as Allen summarized and we highlight on slide three, we continue to have positive business momentum with strong customer activity.

We've reviewed some of our year-over-year results on page four. Compared with the third quarter of 2018, revenue was stable with an increase of $1 billion in non-interest income driven by the sale of our Institutional Retirement and Trust business, largely offset by a $947 million decline in net interest income. Our expenses increased $1.4 billion from a year ago, driven by $1.3 billion of higher operating losses reflecting higher litigation accruals. Our net charge-off rate remains near historic lows at 27 basis points. We had a $50 million reserve build in the third quarter compared with the $100 million reserve release a year ago.

We maintained strong capital levels even as we reduced common shares outstanding by 9% and increased our quarterly common stock dividend by 19% from a year ago. I will be highlighting most of the balance sheet drivers on page five throughout the call, so we will turn to page six. Our effective income tax rate increased to 22.1% in the third quarter, reflecting a net discrete income tax expense of $443 million, predominantly related to the non-tax-deductible treatment of the $1.6 billion discrete litigation accrual. We currently expect the effective income tax rate for the fourth quarter to be approximately 17.5%, excluding the impact of any unanticipated discrete items.

Turning to page seven, average loans were up $10.3 billion from a year ago and increased $2.3 billion from the second quarter. This was the first time we had both year-over-year and linked quarter growth in average loans in nearly three years. Period-end loans increased $12.6 billion from a year ago with growth in C&I, first mortgage, credit card, and auto loans partially offset by declines in commercial real estate, junior lien mortgage, and other revolving credit and installment loans. We grew loans even as we sold or moved to held-for-sale a total $7.4 billion of consumer loans over the past year.

I will highlight the drivers of the linked quarter growth in loans starting on page nine. Commercial loans were stable linked quarter as growth in C&I loans and leased financing was largely offset by declines in commercial real estate loans. C&I loans were up $2 billion with broad based growth in corporate and investment banking and the purchases of CLOs in loan form in the credit investment portfolio.

These increases were partially offset by declines in commercial banking and lower government and institutional banking and middle market lending and in commercial capital driven by seasonally lower commercial distribution finance dealer floor plan loans. Commercial real estate loans declined $2.2 billion from the second quarter with declines in both commercial real estate mortgage and commercial real estate construction loans reflecting increased market liquidity, higher refinancing activity, and continued credit discipline. Leased financing increased $276 million from the second quarter, driven by growth in large ticket direct finance leases in equipment finance.

As we show on page 10, consumer loans increased $5 billion from the second quarter. The first mortgage loan portfolio increased $4.2 billion from the prior quarter driven by $19.3 billion of originations held for investment and the purchase of $1 billion of loans as a result of our exercising service cleanup calls to terminate over 20 pre-2008 securitizations. This growth was partially offset by pay downs as well as sales of $510 million of PCI mortgage loans. Junior lien mortgage loans were down $1.2 billion from the second quarter as pay downs continue outpaces new originations. Credit card loans increased $809 million primarily due to seasonality. Our auto portfolio continued to grow with balances up $1.1 billion from the second quarter.

Originations increased 9% to $6.9 billion. We have been successfully regaining market share while maintaining our credit discipline. Our market share growth reflects the benefit of the transformational changes we have made in the business including process improvements that have resulted in faster credit decision response times.

Turning to deposits on page 11, average deposits increased 2% from both a year ago and the second quarter. Average deposits increased $22.4 billion from the second quarter with growth in wholesale banking as well as retail banking deposits which continue to benefit from promotional rates and offers. Our average deposit cost of 71 basis points increased 1 basis point from the second quarter, the lowest linked quarter increase since the fourth quarter of 2016.

The increase from the second quarter was driven by continued retail deposit campaign pricing for new deposits so that we begun lower promotional rates in terms in response to market conditions. The increase was also impacted by unfavorable deposit mix shifts.

On page 12, we provide details on period-end deposits which grew 3% from a year ago and 2% from the second quarter. Wholesale banking deposits were up $6.6 billion from the second quarter driven by seasonal growth in middle market and business banking as well as growth in our commercial real estate business. Consumer and small business banking deposits increased $11.9 billion from the second quarter driven by higher retail banking deposits including growth in high yield savings and CDs. Wealth and investment management deposits grew as clients reallocation of cash in the higher yielding liquid alternatives slowed during the quarter.

Mortgage escrow deposits grew $4.1 billion from the second quarter reflecting higher mortgage payoffs. These increases were partially offset by a $2.5 billion reduction in corporate Treasury deposits, the second consecutive quarter of declines. Net interest income declined $470 million from the second quarter primarily due to balance sheet re-pricing driven by the impact of the lower interest rate environment as well as $133 million of higher MBS premium amortization costs due to higher pre-payments.

We currently expect MBS premium amortization to continue to increase in the fourth quarter but at a slower pace. We also had lower variable income and smaller positive impact from hedge ineffectiveness accounting results. These declines in net interest income were partially offset by favorable balance sheet growth and mix and the benefit of one additional day of the quarter. As you can see on the chart on this page, rates have been volatile and the yield curve has flattened significantly over the past year.

Net interest income was down 8% in the third quarter and down 4% in the first nine months of 2019, compared with the same periods a year ago. As we stated last month, we currently expect net interest income to decline approximately 6% for the full-year compared with 2018. As always, net interest income will be influenced by a number of factors including loan growth, pricing spreads, the level of rates and the slope of the yield curve.

Turning to page 14, non-interest income increased $896 million for the second quarter driven by the gain from the sale of our institutional retirement and trust business.

Let me highlight a few of the other linked quarter trends. Trust and investment fees were down $9 million, growth and retail brokerage advisory fees, asset base fees in our asset management business and investment banking fees was offset by the decline in trust and investment fees as a result of the sale of our IRT business. While we no longer recognize trust and investment fees from this business, we will continue to administer client assets for up to 24 months, and the buyer will pay us a fee for certain costs we incurred during this transition period.

This fee was $94 million in the third quarter and was recognized in other non-interest income. Mortgage banking revenue declined $292 million from the second quarter driven by a $419 million decline in servicing income primarily due to the valuation adjustments on our MSRs reflecting higher prepayment rate estimates. Partially offsetting this decline was $127 million increase in net gains on mortgage loan originations and sales activities. Mortgage originations increased $5 billion from the second quarter due to higher refi volumes from lower interest rates with refis increasing to 40% of originations in the third quarter. We ended the quarter with a $44 billion unclosed pipeline consistent with the second quarter and we currently expect fourth quarter originations to remain at a similar level to the third quarter.

Residential held for sale mortgage loan originations totaled $38 billion in the third quarter and the production margin on these originations increased to 121 basis points with higher margins in both retail and correspondent channels, driven by capacity constraints. We had $956 million of net gains from equity securities in the third quarter primarily due to realized and unrealized gains from our affiliated venture capital and private equity partnerships. These gains were partially offset by lower deferred comp plan investment results which are largely P&L neutral.

Turning to expenses on page 15, expenses increased from both the second quarter and a year ago, largely due to higher operating losses, primarily reflecting litigation accruals.

To explain the drivers we will start on page 16. Expenses increased $1.8 billion from the second quarter driven by a $1.7 billion increase in operating losses. The increase in compensation and benefits reflected higher salaries expense primarily driven by one additional day in the quarter, a change in staffing mix and higher severance expense partially offset by lower deferred comp expense.

Infrastructure expense increased due to higher equipment expense reflecting the $105 million impairment of capitalized software, predominantly in our wealth and investment management business as well as higher occupancy expense. These increases were partially offset by lower advertising and promotion, FDIC expense, as well as lower T&E expense.

As we show on page 17, expenses increased $1.4 billion from a year ago, driven by $1.3 billion of higher operating losses. As we've previously discussed, investments and risk management including regulatory compliance and operational risk as well as data and technology have exceeded expectations and have offset the expense efficiency we've achieved in other areas. We currently expect our 2019 expenses to be approximately $53 billion, which is at the top end of our $52 to $53 billion target range. This excludes annual operating losses in excess of $600 million and also excludes deferred comp expense, which is largely P&L neutral and total $476 million through the first nine months of the year.

Turning to our Business segments starting on page 19, community banking earnings declined $2.1 billion from the second quarter, primarily driven by higher operating losses reflecting higher litigation accruals.

On page 20, we provide our community banking metrics. We have 30.2 million digital active customers in the third quarter up 4% from a year ago, including 7% growth in mobile active customers. Primary consumer checking customers grew for the eighth consecutive quarter on a year-over-year basis.

Branch customer experience survey scores have increased for five consecutive quarters and reached their highest levels in more than three years in September. The continued improvement in these scores reflects the transformative change we've been making to provide a better customer experience. We've enhanced training and coaching for our team members in our branches including an increased focus on educating our customers about our industry leading digital capabilities.

On slide 21, teller and ATM transactions declined 6% from a year ago reflecting continued customer migration to digital channels. We've consolidated 130 branches in the first nine months of this year, including 52 branches in the third quarter. We continue to have strong card usage with credit card purchase volume up 5% from a year ago and debit card purchase volume up 6% from a year ago. This was the eighth consecutive quarter of achieving at least 5% year-over-year growth in both debit and credit card purchase volume.

Turning to page 22, wholesale banking earnings declined $145 million from the second quarter, driven by lower net interest income reflecting the impact of the lower interest rate environment. We've expanded the key metrics that we provide for this business and as you can see we grew unfunded lending commitments on both a year-over-year in linked quarter basis. We're a large processor of commercial payments as evidenced by our ACH payment and commercial card spend and we grew our year-to-date market share and investment banking driven by higher market share in loans indications. We're also a market leader in high-grade issuances. We had record volume in the third quarter commensurate with the industry with September being particularly strong and the fourth highest month on record for the industry fueled by the rally and treasuries.

In general, our commercial customers continue to see moderate demand and no widespread issues related to trade uncertainty and interest rate changes. We'll continue to monitor business performance closely, but today, while our customers are cautious, the most common concern they identify their ability to hire enough qualified workers. Wealth and investment management earnings increased $678 million from the second quarter, driven by the gain on the sale of our institutional retirement and trust business.

Turning to page 24, we continue to have strong credit results with our net charge-off rate declining to 27 basis points in the third quarter. All of our commercial and consumer real estate portfolios were in a net recovery position in the third quarter. Credit card net charge-offs have been relatively stable as we've been thoughtful in our efforts to generate new account growth, including the launch of our Propel American Express Card last year, and while auto and net charge-offs increased from the second quarter due to seasonality, they were down from a year ago even as we've grown originations by 45%. We're generating growth in originations, while maintaining our strong credit discipline with consistent loan de-value, payment to income, and FICO scores.

Non-accrual loans declined $377 million from the second quarter with lower non-accruals in both the commercial and consumer portfolios. Non-accrual loans were 58 basis points of total loans, their lowest level in over 10 years. We closely monitor our commercial portfolio for signs of weakness and credit quality indicators remains strong. Our internal credit grades are at their strongest levels in two years and since third quarter of 2017 our criticized loan balances have declined 20% with broad-based improvement across all commercial asset classes.

We currently estimate that the impact of the adoption of CECL at the beginning of next year will be a reduction in our allowance of approximately $1.4 billion. Just over half of the reduction reflects the expected decrease for commercial loans given their short contractual maturities exceeding the expected incremental allowance for consumer loans that have longer or indeterminate maturities.

As a reminder, we have a smaller credit card portfolio than our large bank peers which reduces the impact CECL adoption will have on our consumer loans. The remainder of the expected reduction in our allowance predominantly related to the increase in collateral value of residential mortgage loans, which were written down significantly below current recovery value during the last credit cycle. The ultimate affect of CECL will depend on the size and composition of our loan portfolio, the portfolio's credit quality and economic conditions at the time of adoption, as well as any refinements to our model's methodology and other key assumptions. Also, as the industry experiences credit cycles, we anticipate more volatility under a lifetime reserving approach versus the incurred loss approach.

Turning to capital, on page 25, CET1 ratio, fully phased-in, decreased to 11.6% driven by returning $9 billion to shareholders through common stock dividends and net share repurchases in the third quarter. This was up 50% from the $6 billion we returned last quarter. As a reminder, similar to last year, our plan subject to market conditions and management discretion is to use approximately 65% of the gross repurchase capacity under our most recent capital plan in the second-half of 2019.

In summary, while we had a number of significant items that impacted our third quarter financial results, we had strong underlying business fundamentals, including growth in loans and deposits, increased customer activity, strong credit performance, and higher capital returns. I'm optimistic that our continued efforts to transform Wells Fargo and the fundamental strengths of our franchise will continue to position us well for success.

And Allen and I will now take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question will come from the line of Erika Najarian with Bank of America.

Allen Parker

Good morning.

Erika Najarian

Hi, good morning. Morning, as we think about what the forward curve is telling us, and obviously it's been quite a volatile outlook for the forward curve, and some of the momentum that you talked about on the growth side in lending. As we think about the 6%

NII decline in 2019, given sort of the forward curve plus that momentum, how should we think about NII decline expectations for 2020?

John Shrewsberry

Yes, well, it's complicated, because there's a lot of things going into it include where rates go versus what the market is suggesting, what happens with loan pricing, deposit pricing, and a variety of things, but if we, in the various scenarios that we run thinking about, let's say, the 9/30 implied forward curve, which suggests Fed funds in the 170 area, 12/31 of this year the 10-year just under 170, and then a year forward, Fed funds in the 120 area and Fed funds still in the 170 -- pardon me, 10-year still in the 170 area. That with a range of assumptions about loans and deposits probably gets us to down low-to-mid single digits in net interest income. Maybe not as much of a decline from '18 to '19, but versus a number of scenarios, but it seems to be that would seem to capture it.

Erika Najarian

Got it. And my second question, obviously you can't speak for the new CEO. The questions that we're getting from your investor base is that they're trying to gauge how much further investment there needs to be sort of going forward. And you mentioned yourself, John, that the investments in risk compliance and data had exceeded your expectations. And again, you can't speak for Charlie, but as you think about how those investments played out relative to investments in, let's say, innovation, and as you think about where you are versus peers, is there a significant catch-up gap because you've spent a lot of those dollars on risk compliance and data, how should we think about investment spend from here?

Allen Parker

Yes, so I think when Charlie arrives, we'll conduct a complete strategic review of where all the businesses stand and where we -- what our opportunities are, et cetera, including a review of how we've been investing on the risk compliance side, et cetera, and then formulate a view going forward. One thing that probably doesn't get enough focus is that a lot of the money and time that we've spent on the risk and control side of things really does enable further innovation. So, the money we spend in technology and data, for example, has huge customer impact down the road. So, there's not an either or necessarily, there's a lot of mutual benefit from running a more controlled environment. But that will be work that we all do together with Charlie after he arrives and then present conclusions at the right time.

Erika Najarian

Got it, thank you.

Operator

Your next question will come from the line of Scott Siefers with Sandler O'Neill.

Scott Siefers

Good morning, guys. Thanks for taking the question.

Allen Parker

Hi, Scott.

Scott Siefers

John, sort of a follow-up question on costs, I guess if I look at the reiterated 2019 expense guide, it implies a pretty meaningful downdraft in costs in the 4Q, maybe if you could just take a moment to go through sort of the puts and takes and how you bring costs down in the coming quarter? And then just along the lines of costs into 2020, I know you had previously suggested that costs could be flat in 2020, is that still something you're thinking or now with Charlie coming on board, do we sort of just sort of wait till he comes on and take a look at things, and then give him complete discretion on what the cost outlook looks like?

John Shrewsberry

Yes, so on the second half, I think you answered that, which is we should wait and allow him to have an input onto the composition of how we're spending money in the future. For Q4 though, as you pointed out, it does imply a step down. And I think the biggest sources of that are other professional fees and some labor-related expense. But it does require that, that’s how the math works, and that's how we're forecasted right now.

Scott Siefers

Okay, perfect, thank you. And then just separately on mortgage, I think you had said that the originations should stay around this quarter's level into the fourth quarter. Hopefully, I heard that correctly. Maybe if you could just sort of comment on where you see gain on sale margins trending with a nice uptick this quarter? And overall, given the moving parts that you see, should we expect mortgage revenues to be at or above what we saw this quarter, particularly if we don't get the same sort of MSR noise?

Allen Parker

Yes, so on the origination side, it's hard to say what the full quarter gain on sale is, but we do think it'll be in the neighborhood of where it's been recently, it was just, call it, 120 basis points, which was a big tick up and welcome. On the servicing side, well I wouldn't expect there to be any revaluation in the fourth quarter. We think we've got that in the third quarter. We -- recall that we are in a flatter curve environment, and so the carry for holding treasuries is a hedge to the MSR. Sometimes, it works for us in a steeper curve environment, and sometimes it's either neutral or works against us when the curve gets flatter. So we shouldn't earn as much on the hedge but we probably wouldn't have the type of valuation items we saw in Q3.

Scott Siefers

Okay, all right, terrific. Thank you very much for the color.

Allen Parker

Yes.

Operator

Your next question comes from the line of John McDonald with Autonomous Research.

Allen Parker

Hi, John.

John McDonald

Hi, good morning. Hey, John, wanted to ask about deposits -- deposit pricing. With the deposit cost increases slowing, might we have seen kind of the end of the deposit cost rise for you guys this quarter assuming rates stay flat to down from here, kind of just trying to think if this could be the max paying quarter for NIM where you had the deposit costs up and loan yields down, and maybe some just puts and takes for the fourth quarter on NIM versus this quarter?

John Shrewsberry

Yes, so my expectation is that deposit costs will be cheaper in the fourth quarter reflecting what you described in terms of kind of the burning out of the higher cost deposits that got layered in before the Fed began to ease. Having said that, that is still -- there was less room to go down on the deposit side, and so if rates continue to move down on the asset side it still works against us even if deposit costs aren't rising. So we have to be as vigilant as we can to keep deposits costs as low as it makes sense for the businesses and customers that we serve. But even if they're not rising there's still leverage working against us in a declining rate environment.

John McDonald

And in terms of good guys, bad guys, and fourth quarter versus third, what's worse and what's maybe better than what you experienced this quarter on just a NIM percentage?

John Shrewsberry

Well, I think we're imagining having a little bit higher level of MBS premium amortization. So, that will be working for us in the fourth quarter. It depends, I'd say in terms of wholesale pricing, wholesale banking, deposit pricing. Working with the higher beta customers to make sure that we reduce those as quickly as possible, there is probably more room to run on that with a little bit of divestiture time that could be a benefit. The burnout of more promotional activity on the consumer side is probably a net benefit, and those are some of the bigger items.

John McDonald

Okay, and guys, one more follow-up on the expenses.

John Shrewsberry

Sure.

John McDonald

Is it accurate for us to think that there are some elements of your inflation and expenses that are temporary, and helping you get to the best-in-class and satisfy your regulators, and then other parts that are permanent, like helping you stay best-in-class and keep satisfying regulators and some of them what you're building might get more efficient over time, and obviously a lot of it will stay?

John Shrewsberry

Yes, I think it's a good point, there's a real opportunity for, for taking best-in-class and then making it much more efficient. I think we should -- maybe it was last quarter, one of the things that we mentioned is that we're building a control environment for the company as it exists today, and there is just through process consolidation and process reengineering, there's an opportunity for the company to be a whole lot more simplified as we roll forward, and both the cost of delivery and the cost of overseeing that from a risk and control perspective would be expected to be more efficient. Some of that is converting multiple manual processes to just a fewer processes, and some of it is from converting manual process to automated process, but all of that is upside from where we -- from the day that we determine that we think we've achieved the best-in-class requirement from an operational risk and compliance perspective.

John McDonald

Okay, thanks.

Operator

Your next question comes from the line of Ken Usdin with Jefferies.

Ken Usdin

Hey, thanks. Hey, John, one follow-up on the NII side, so you keeping their minus 6 NII I got for the year kind of gets you 11 fours for the year, and down even five next year kind of holds you at that 11 four-ish, and so I know there're so many potential permutations of what happens with the rate environment, but maybe you can just help us talk through how much you expect the balance sheet to grow then, or how -- versus how close you're starting to get towards the asset cap, and what constraints if anything, might you have as this gets further out? Thanks.

John Shrewsberry

I mean within the relevant range of expectations of loan and deposit growth, I wouldn't think of the asset cap as being as really coming into play in our forecast horizon, in part, because there are plenty of levers that we can pull that don't have real customer impact in terms of consumers and our business customers, and we've talked about some of those before in terms of some of the institutional deposits that we take or other wholesale funding that we use, and then, there are some assets that don't work that hard for us from a balance sheet perspective. So, I guess the low single-digit growth rates for loans and deposits is probably a reasonable proxy for a reasonable placeholder for thinking about how 2020 unfolds, could be a range of different outcomes, but that would be consistent with what I mentioned earlier in terms of how you might forecast the different rate paths and getting to a low to mid single-digits down percentage in net interest income for 2020 versus 2019.

Ken Usdin

Understood, thanks, and a follow-up on the fee side, we got the IRT coming out, did you spoke about it, was in the deck, and then you've got Estill [ph], can you just help us understand how you are thinking about how that just nets out as we get past this year as well in terms of revenue and expense trajectory? Thanks, John.

John Shrewsberry

Yes, well, so with IRT, I think we actually have a -- this page in the back of the supplement that shows you exactly what to expect there, and not to oversimplify it, but it's on the order of $100 million a quarter I think from both revenue and expense, at least as we process it. Estill coming out starting in the fourth quarter, it was probably a little bit bigger in terms of dollars of revenue per quarter, and you'll see it mostly in the commercial mortgage brokerage line item in the P&L, it shows up in a couple of others areas too and have investment banking fees, but similarly the expenses approximate the revenue in our own experience. So when we finished Q4 and we talked about our 2019 expenses, and we will provide a reconciliation for people to be able to show where we ended up and we'll be sure that to call out both of those things. Actually, it won't really impact -- IRT won't impact it because the expenses are still in our run rate, and we're recovering them, Estill will be a minor adjustment, because there won't be expenses for Q4.

Ken Usdin

Understood, thank you, John.

Operator

Your next question comes from the line of John Pancari with Evercore.

Allen Parker

Hi, John.

John Pancari

Good morning. Staying on the loan growth topic, you saw some pretty good declines in the commercial real estate portfolios this quarter again and just want to get your updated thoughts there, that's the one area that you're expect to see some runoff still or another words lack of growth, I guess? Thanks.

Allen Parker

So we had a couple quarters with small growth and then we shrunk again a little bit this quarter. As I understand it, I think our commitments for construction financing are actually up in the third quarter, which will come through as funded loans. That really is one market where

there's late cycle behavior. There's lots of non-bank competitors, there are more non-bank competitors than bank competitors. And so we really have to pick our spots in order to maintain our risk reward, credit and pricing and loan terms quality, and it's also one of those areas where, frankly, your weakest loans end up getting refinanced away from you, which is also late cycle behavior by the way, so we're still very comfortable with what we have on the books, but I wouldn't look for it to grow meaningfully until the cycle turns and until our best customers have really interesting opportunities to put their own capital to work and we help them do it. So I could be wrong, but it feels to me like it's going to be treading water while our best customers either refinance deals that were already in or prudently take advantage of what the market offers them.

But I don't see it as an area for outsized growth.

John Pancari

Okay, that's helpful. And then separately on the fee side, the equity investment gains saw a pretty good jump in the quarter, if you could just give us a little bit of color on what drove that and if you can give us a little thoughts in your outlook there? Thanks.

Allen Parker

Sure. There's a couple things that drive that, one is it's a great time to be realizing from both private equity and venture portfolios. And so, our teams have been selling into that and that's where we've been at the high point in the cycle for a while now. So with respect to the second part of your question, I expect that to reflect what kind of private market we're in and if it still is a strong and financing is accommodating it as it is today then I expect that that they'll continue to harvest and things will be good. It's a little bit harder of an environment for them to be putting capital to work because asset prices are so high. The other thing that contributes to is we had a change in accounting a year or so ago which is causing us to recognize unrealized gains where they said there's a subsequent capital raise in a private deal that causes us to have to mark up our position, and it's always been true if one of those companies goes public, but our affiliate still ends up owning shares for a period of time that we write up, we recognize the gain even though we haven't liquidated our position. So that's contributing, that will contribute to some more volatility here because that can only be one way even though it's been a benefit for the last year.

John Pancari

Okay, got it. Thank you.

Operator

Your next question comes from the line of Matt O'Connor with Deutsche Bank.

Allen Parker

Hi Matt.

Matt O'Connor

Good morning. So it seems like the NIM percent could bottom somewhere in the 250s, and I'm just trying to get a sense of is that like a reasonable NIM when I think about your mix, right, everyone's trying to compare you to both your bigger peers and your smaller and you don't have as much credit card as some, does that hurts you, also not as much trading book as some that should help you. And then, you know, just to throw a couple of things like there's still some assets where it seems like you're over earning, like in the securities book, but there's also some deposits that you're overpaying. So what are your thoughts around, kind of, again based on some of the things that you set for 2020 in NII and thinking about just keeping rates for the four curve is like that NIM in the 250s like is that a normal NIM for you in this backdrop, or there's still some?

John Shrewsberry

So we're not currently forecasting over our horizon to quite hit that level. I mean it's not that far off either of where we are today or what's likely to unfold. I agree that but while we do have some special things on the asset or the liability side. The sale of Pick-a-Pay loans they were contributing to interest income and to them is probably something that isn't going to be replicated. So I think once that fully runs through the comparison periods, I mean it's affecting them already. That's out, and I don't think there is that much more on the loan side. It's high yielding that's rolling off.

On the liability side, we did mention that there are some promotional deposits and other things that are burning down because they were in place as we were on the way up in rates, and so that will be a benefit, but I don't think we get quite to 250 in our forecast horizon. A lot of things go into that, of course, and we don't manage to them. We're much more thinking about dollars of net interest income, but if that's helpful.

Matt O'Connor

Okay, and I was kind of thinking 250 is broadly speaking, but that is helpful. And then just specifically like as we think about, you know, exiting fourth quarter at net interest income, you're obviously going to be caring or absorbing higher than normal bond premium amortization. So we don't want to run right all that. What is the level of the bond premium amortizationthis quarter? You said they increased at 131, but what's the run rate?

John Shrewsberry

Yes, for MBS it's just under $400 million for the quarter and it was just under $250 million for the second quarter, and we think it'll be up a little bit in the fourth quarter. So it's been about $775 million year-to-date through the third quarter.

Matt O'Connor

Okay. And then just last question all this, as we think about exiting this year, just assuming rates stay where they are now, does that go to zero or there's still going to be just some ongoing amount in the fourth quarter?

John Shrewsberry

I assume there'll still be some ongoing amount, if we stay in this context for 10 year and mortgage rates with the velocity of prepayments. You heard me mentioned that we're at about 40% refis right now in our own production, and our pipeline is this big coming out of the third quarter as it was going in. And so, that may take months or even quarters for the -- in the moneyness of the outstanding stock of mortgages, you know, agency mortgages to work their way through the system, but there is a whole lot more people who are in the money for refi today than a few quarters ago. So I don't think that's going to abate quickly.

Matt O'Connor

Okay. And I could just be greedy here and squeeze in one other thing. You've talked about the increased spending in regulation compliance controls related areas versus two or three years ago. Is there a dollar amount that you can provide on that increase or I think at one point you did talk about the headcount increase, maybe you could update that and we can make some estimates if you can't give us a dollar amount? Thank you.

John Shrewsberry

Yes, I don't have a crisp answer for you only because it appears everywhere. It appears in the front line and appears in the second line, it appears in technology, it appears in a variety of areas. I think we'll try and put a comparison together for folks to get a picture of not only what we think about it, how we think about it historically, but how we think about it going forward back to John McDonald's question of what do we look like at the high watermark versus what efficient looks like over time. I think matching detail that people should be able to understand as that story unfolds, and I think as we finish this work that we do with Charlie and we talk about what the next steps are expense-wise, that's a reasonable expectation from our team.

Matt O'Connor

Okay, thank you.

John Shrewsberry

Yes.

Operator

Your next question comes from the line of David Long with Raymond James.

Allen Parker

Hi, David.

John Shrewsberry

Hi, David.

David Long

Good morning, everyone. Looking at your securities portfolio, what type of yield do you have rolling off the securities book this quarter, and then what are you looking at for reinvestment yield?

Allen Parker

Yes, I think in general we're reinvesting about 25 basis points down from what has been rolling off, and of course it depends on whether it's agency MBS, which is the bulk of our purchases. We also have some treasuries and agency debentures, and we have some structured products and other things, but on average, I think our purchases in Q3 were just North of a 3% yield and what's been rolling off from a coupon perspective has been high threes from a yield perspective has been not terribly different than 3%. So, in agency MBS in particular, I want to say that we're probably down, gosh, 25 to 25 plus basis points on a reinvestment rate basis.

David Long

Okay, got it. And then the second question I have relates to the potential future litigation losses and I know in the -- in your Q, you give the number and it seems to be rising in most course. Do you have that number? What the number may be here in the as of September 30?

Allen Parker

No, it'll keep -- the number will keep being refined until we file the Q, which will happen in a couple of weeks. So be on the lookout for that for the latest, which will include everything we know up until that day.

David Long

Got it. Thank you for taking my questions.

Allen Parker

You bet.

Operator

Your next question comes from the line of Vivek Juneja with JPMorgan.

John Shrewsberry

Hi, Vivek.

Vivek Juneja

Hi. Hi, John. I thought let me just start with a question that either if you could respond to. So there was an issue that came up in the middle of the third quarter that the New York Times reported about accounts close that we were being charged fees after they were closed, can you give some color on this issue when it was discovered, a number of customers, what's involved? Were you on the timeline of all of this, and actually overarching why this even is coming up now?

Allen Parker

Vivek, thank you for the question, I guess what I would say is that at this point, there's really not any further information that we can give you with regard to that situation. We have obviously in response to the article that appeared gone back and looked at all our account closure information and we've been working very hard. closely with our regulatory agencies ever since then, we're at the point now where we're coming to some conclusions about what happened, but it would frankly be premature at this point for me to really give you any information in that regard, and we're taking a look at what happened. We're trying to determine the veracity of what was said in the New York Times. And perhaps most important, we're trying to determine whether we ought to make any changes at all with regard to the way that we've been conducting ourselves in that arena. I wish I could be more forthcoming in terms of information, but it's still in progress, and it's been an effort in which we've been engaged very closely with our regulators.

Vivek Juneja

You mean when you say conducting yourselves as in just the whole process of how it works, account closures et cetera or something else?

Allen Parker

Yes, the whole process of account closures is complicated in any financial institution because there are situations where people close their accounts voluntarily, whether they call a call center or they walk into a branch, and there are also situations where accounts have to be closed for legal or regulatory reasons, and there are a variety of considerations that go into how that's done, and we're going through very carefully and looking at all those considerations and coming to the conclusion as to the changes, if any, that we ought to make with respect to the way that we've handled ourselves in the past.

Vivek Juneja

Completely separate question for John. John, you mentioned about the promotional retail deposits. Are you completely stopping it? Are you just reducing the rates that you're offering by the amount of rate cuts that you've seen which is what several other players have done with their higher yield offerings?

John Shrewsberry

So there always be some level of promotional activities should reflect the market conditions that we're competing in both in terms of rates and terms. I think like a lot of people and with the expectation of lower rates shortening up initial terms, so that we are not overpaying for a longer period of time, they might have previously felt like it was necessary in a rising rate environment. So we've -- there's some of it in the third quarter, we've eased off on pricing, we've eased off on terms, but just like your firm, there will always be some amount of it to make sure that we're competitive market-by-market and to test and learn.

Vivek Juneja

All right. One last, if I may. You in the past have given us loans to non-depository financials outstanding. Could you give the number what that is this quarter?

John Shrewsberry

Let's see. I'm looking at the papers around me here. I don't think it's changed much during the course of the quarter. Yes, I don't know. We'll follow-up with you on that. There wasn't a meaningful move in that category during the course of the quarter, but I'm not having handy.

Vivek Juneja

Okay, thanks.

Operator

Your next question comes from the line of Eric Compton with Morningstar.

Allen Parker

Hi, Eric.

Eric Compton

Good morning. Thanks for taking my question. So my first question is you made the comment that one of the areas of expenses that you expect to be helping you meet your full-year guidance is from that other professional fees line item, and I was just curious if you have any more color around why that might be dropping? What might be causing that, if that's related to perhaps progress on some of the risk and compliance spending and maybe taking some more or higher percentage of those activities in-house? Any more color on what's driving that?

John Shrewsberry

Yes, that's a good question. So some of it is definitely having taken some of it in-house. The amount by which we're talking about it changing frankly isn't indicative of a giant pivot one way or the other; it's still a category that's too high. It represents both consulting type firms where we've been getting expertise as well as labor augmentation or staff augmentation, particularly in technology labor where we've been, we've been hiring people as contractors, where we haven't been able to hire as quickly as necessary. I think like all firms, there's a portion of our workforce in that area that is on contract. So with the shift in the fourth quarter is the current forecast just based on what's rolled on and what's rolled off and the current body of work, but there's still a lot of it going on. It's still a level that's too high, and as we roll forward and think about what efficient looks like, there's no doubt that that category coming down, substantially will be high on the list of sources in a more efficient state to be operating in.

Eric Compton

Okay, that's helpful, and then one last question. I appreciate it, if you don't want to comment on this too much, but just going back to the legal reserve estimate, understanding the official number will come out in the Q, but we had that $800 million jump and now we're getting that $1.6 billion charge or the jump in the high-end of the legal reserve estimate, and now the charge in the current quarter and just the operating losses, and just curious if there's any color on, do you get a sense we're starting to get more towards the light at the end of the tunnel when it comes to this? Should we start see this, the legal reserve estimates start to trend down? Is that your sense? Just any more color around, I guess, behind the scenes, what's going on there?

John Shrewsberry

As you preface to your question with we really can't provide anything in the way of color on this. As you know, we don't provide information as to the portion of our reserves that's applicable to any particular litigation or other items and with regard to the DOJ and SEC investigations that began in 2006, we really don't have any update beyond what we said in our prepared remarks and what we previously disclosed in our last quarter 10-Q, our discussions with the DOJ and SEC are ongoing and when we have more information to disclose, we'll of course do so.

Eric Compton

Absolutely, you said 2006 you meant 16?

John Shrewsberry

Yes, I'm sorry. There is nothing from 2006.

Allen Parker

Nothing from 2006, thankfully.

Eric Compton

Okay. And I appreciate it. Thanks for taking the questions.

Allen Parker

Sure. And while the next one is coming back, the number is $104 billion as of September 30 for the exposure, total exposure to non-bank financials.

Operator

Your next question will come from the line of Saul Martinez with UBS.

Saul Martinez

Hey, guys, thanks for taking my question. Good morning. So I feel like hate to beat a dead horse with the NII, but I feel like either I'm taking the guidance to literally or missing something, but the outlook is still for NII to decline 6% on the reported basis and I guess $1.8 billion decline versus the first-half, it seems to suggest that the fourth quarter NII is roughly about $11 billion and even if you do a little bit better than that, it still implies in a pretty substantial declines in NII in NIM degradation, the fourth quarter versus the third quarter and everything a lot of what you said John, in terms of less incremental headwind from premium, deposit costs maybe starting to peak out and even reduce a little bit or fall a little bit next quarter. The piece to headwind from the purchase credit impaired PCI should start to moderate just because you're selling less of it at least on a sequential basis. It seems like that the balance sheet mix and re-pricing element is pretty pronounced to get there. So I guess what am I missing and is it really just that the impact of the rate cuts, the lower long end, is that pronounced in terms of the impact on asset yield?

John Shrewsberry

Well, I think at the asset side that's sort of fully reflecting re-pricing down. We talked about the deposit costs not being higher, probably being a little bit lower, and it gets you to the types of numbers that you described.

Saul Martinez

Okay.

John Shrewsberry

Very close.

Saul Martinez

Okay, but the math is right, I guess the math is right that 6% would be in the 11 billion or so range for the fourth quarter on a reported basis?

John Shrewsberry

That's right.

Saul Martinez

Okay, all right. I just wanted to be clear. So wanted to just maybe ask about a different topic and I apologize I was on a little bit late at Allen if you addressed it, but any update on where you stand on the consent order and remediating the operational risks and controls, and it seems like there's a lot of blocking and tackling there in terms of all of the processes that you're looking at identifying risk and controls and were appropriate remediating those. Can you just give us a sensing on, you know, regardless of what the Fed does and when they lift it, where you feel like you are in that process and do you feel like you need to get past that before you can really attack the cost structure in a meaningful way?

Allen Parker

Yes. Thanks. Let me start on that and I'll turn it out to John, I mean our conversation with our regulators are of course confidential supervisory information, but I can say that our engagement with the regulators has been very constructive and we're in constant dialogue with them on a number of fronts. As everybody recalls, several of the regulators made public statements earlier in the year in which they express their disappointment with the progress we've made up until that time. In response to that criticism, which of course we accepted over the last six months, we re-coupled our efforts with regard to trying to satisfy their expectations, and I made clear, I know Charlie will as well that the entire Wells Fargo team must continue to act assertively and decisively to meet the regulators expectations going forward.

With regard to the issues raised in the Fed consent order, the feedback that we are getting from the Fed on a constant basis is enabling us to continue to make progress in terms of responding to their expectations. We're a good ways down the road, but I think it's fair to say that we have a substantial amount of additional work to do and of course at the same time we've designed and implemented and we're constantly working -- doing enhance our new risk management framework, and that's fundamentally transforming how we manage risk every day throughout the organization in a way that I would describe as much more comprehensive integrated and consistent, and at the same time, we're enhancing frontline risk, independent risk management and the audit function. So that we can ensure multiple layers of review and better visibility into issues as they emerge, and obviously the goal of all this is to prevent the occurrence of the kinds of issues that we had in the past. And as John alluded to before, we're also emphasizing operational excellence throughout the company. Our biggest focus there is on business process management in an effort to try to deliver greater consistency.

So I guess what I will say, and I'll turn it over to John to talk about some of the financial impacts. There is a great deal of work to do to meet the expectations of our regulators. They're appropriately high, but we're committed to completing that work. We're working very hard and we're confident that we'll be able to complete the work in a manner that's timely and just as important up to the highest standards of professionalism and durability going forward.

John Shrewsberry

Yes. And so, to the second part of your question, so we've had these efficiency programs in place for the last few years, which began before this biggest push in response to the Fed consent order and some other regulatory feedback, but through that process, we've got hundreds of programs that have gone activity-by-activity and said about taking unnecessary costs out, and then at the same time we've embarked on this getting it right from an operational risk, compliance, governance perspective, including all of the enabling technology, which is where all this money is being reinvested.

So, as I mentioned earlier on this call, the big opportunity once Wells Fargo both internally and from a regulatory perspective has chin the bar for being excellent at operational risk, compliance, and governance overall like that we believe that we are in credit risk and some other areas, is a massive simplification because as we go down this business process management path, we inventory and uncover the fact that we do just about everything we do in many different ways, and there is a huge opportunity to compress that to get more consistent. It improves the customer experience, the team member experience. It's easier to control. It's easier to automate, and it's much less expensive to deliver, and I think from an investor perspective, it's important to know that we are fixing our status quo Wells Fargo the way that our individual processes have currently operate and then there is the opportunity to re-engineer.

Now that may look different after we have sat down and done a complete strategic review with Charlie, but it is how the team has set about doing the business or doing the remediation that's necessary to improve the company today starting with the way things are done today, but there is from my perspective an extraordinary efficiency opportunity in modernizing that.

Saul Martinez

Great. That's really helpful. Thank you.

Operator

Your final question will come from the line of Betsy Graseck with Morgan Stanley.

John Shrewsberry

Hi, Betsy.

Betsy Graseck

Hi, good morning. Two quick questions, one just on MSR revaluation, I mean I realized that there was some pre pays in the quarter, and I know that you guys are really good estimating that. So just wondering if there was something else? Or, was it just a more violent movement expected? And is it a onetime in your opinion that it's not going to pop back up I would expect, but just wanted to get your understanding on that?

John Shrewsberry

Yes. Well, it was a bigger move than was expected, and I am always -- I am reluctant to say that it could never happen again, but the way we estimate the customer response to their in the moneyness for a refinance given what we know about -- what type of cohort they are following is the basis of how we estimate that, and it happens -- it's been happening at a faster pace, and so we think we have captured that in this valuation adjustment.

Betsy Graseck

Okay, and then on the auto lending side, I know you highlighted that the reconfiguration, restructuring of that business is now finish, and we saw some really strong results this quarter with originations up. What was it, 9% linked quarter? Do you feel like it's the start of the rebalancing of that auto business? Is this is a run rate that you think you can keep for the - I don't know foreseeable future? I am just trying to get a sense of the sizing of the auto book that you think you can get back to post this restructuring of that business?

John Shrewsberry

Yes, my sense is that if we still liked the risk reward, so if consumer credit stays about where it is and if used car value stay about where they are, that there is an opportunity for us to grow further. So as I mentioned, the growth that we have gotten so far is really by doing more in the same upper rationale on credit tiers, and we previously ran the business with -- including little bit more in the -- at least in the non-prime category, and my sense is that we will probably begin to do that too over the course of the next couple of quarters. We are easing into it, but I don't think of this uptick as aberrant, and I think that there is more to do.

Betsy Graseck

Okay, thanks.

John Shrewsberry

Yes.

Allen Parker

Let me close our call by thanking all of you for your questions and for joining our third quarter conference call. As always, I would also like to thank all our team members for their hard work, dedication, and enthusiasm. Best regards to you all. Take care.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you all for joining. You may now disconnect.