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KeyCorp (KEY) CEO Beth Mooney on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-17-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $0.48 beats by $0.02 | Revenue of $1.63B (1.75% Y/Y) misses by $-12.42M

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KeyCorp (NYSE:KEY) Q3 2019 Results Earnings Conference Call October 17, 2019 9:00 AM ET

Company Participants

Beth Mooney - Chairman and CEO

Don Kimble - Chief Financial Officer

Chris Gorman - President and Chief Operating Officer

Mark Midkiff, - Chief Risk Officer

Conference Call Participants

Scott Siefers - Sandler O'Neill

Ken Zerbe - Morgan Stanley

John Pancari - Evercore

Peter Winter - Wedbush

Ken Usdin - Jefferies

Steven Alexopoulos - JPMorgan

Gerard Cassidy - RBC

Mike Mayo - Wells Fargo Securities

Saul Martinez - UBS

Marlin Mosby - Vining Sparks

Brian Foran - Autonomous Research

Brian Klock - Keefe, Bruyette, Woods

Operator

Good morning. And welcome to KeyCorp's Third Quarter 2019 Earnings Conference Call. As a reminder this conference is being recorded. I’d like to turn the conference over to the Chairman and CEO, Beth Mooney. Please go ahead.

Beth Mooney

Thank you, operator. Good morning. And welcome to KeyCorp's third quarter 2019 earnings conference call. Joining me for the call is Don Kimble, our Chief Financial Officer; Chris Gorman, our newly appointed President and Chief Operating Officer; and Mark Midkiff, our Chief Risk Officer.

Slide 2 is our statement and forward-looking disclosure and non-GAAP financial measures. It covers our presentation materials and comments, as well as the question-and-answer segment of our call.

I'm now moving to Slide 3. And before I review our quarterly results, I want to comment on our leadership transition that we announced last month. In keeping with our thorough and robust succession planning process developed by our Board of Directors, I announced my upcoming retirement effective May 1st of next year and Chris Gorman was appointed President and Chief Operating Officer and a member of our Board of Directors.

Chris will succeed me as Chairman and CEO next May. And I will have opportunities to speak with you over the next several quarters. But I just want to say that my time at Key has represented some of my most rewarding years of my 40 years in banking.

I'm proud at what this team has accomplished as we have transformed this company, our culture, our strategy and our performance. And importantly, I will remain fully engaged over the next seven months and I'm committed to working with Chris for a seamless leadership transition. I look forward to Key's continued success under Chris with our diverse and talented leadership team and I have a very confidence in our future success.

Now moving on to the results we reported this morning. My remarks will adjust for our previously reported fraud loss and notable items in prior periods. So let me start with a few headlines.

Earnings per share grew 7% from the year ago period and 9% from the second quarter. We reached the top end of our targeted cash efficiency ratio range of 54% to 56% with a reported 56% which is our lowest level in over a decade.

We delivered another quarter of positive operating leverage, driven by both revenue growth and a 3% sequential quarter decline in expenses. And we saw solid balance sheet growth and strong fee income with a record third quarter for investment banking and debt placement fees.

On the revenue side, we saw good momentum across our company. We grew both loans and deposits 4% from the prior year, driven by activity in both our commercial and consumer businesses.

We generated another quarter of strong broad based growth in commercial and industrial loans and saw higher consumer loan balances driven by Laurel Road and strength in our consumer mortgage lending.

Non-interest income was up 7% from the year ago period benefiting from strong investment banking and debt placement fees, as well as growth in corporate services and consumer mortgage income.

As I said, non-interest expense was down 3% from the year ago period and reflects the successful execution of our cost initiatives, as well as our ongoing commitment to continuous improvement. And I would remind you that our expense levels relative to the prior year include the addition of our Laurel Road acquisition earlier this year.

Importantly, although we are focused on bringing expenses down, we continue to invest a portion of our cost savings back into the business to drive future growth. And we continue to manage the company with a long-term perspective by taking action to position us to perform through the business cycle. This includes maintaining our disciplined credit writing - underwriting and our risk profile.

We also continue to manage capital, consistent with our stated capital priorities including returning a significant portion of our earnings back to our shareholders. In the third quarter, we increased our quarterly common stock dividend by 9% to $18.50 per share and continue to repurchase shares.

Before I turn the call over to Don, let me just say that this was a good quarter for Key and clearly demonstrates the strength and resiliency of our business model. We saw topline growth in loans, deposits, and fees and paired this with strong expense control. This drove our cash efficiency ratio to 56%, hitting our targeted range this quarter.

Clearly there are some headwinds with lower interest rates and a sign of a slowing economy, and although our clients have turned more cautious, we continue to see good engagement and solid pipelines.

Our business model and the interest rate hedging also positions us well as we move through the different business cycles and rate environments. And expense management also remains a priority as we continue to identify opportunities to further improve efficiency.

We remain committed to reaching our long-term targets, maintaining our moderate risk profile and ultimately delivering results for our shareholders.

With that, I will close and turn the call over to Don.

Don Kimble

Thanks Beth. I'm now on slide 5. This morning we reported third quarter net income from continuing operations of $0.38 per common share. Adjusting for our previously disclosed fraud loss, earnings per share was $0.48. Our adjusted results compared to $0.45 per share in the year ago period and $0.44 in the second quarter of 2019.

As reported in July, we became aware of fraudulent activity conducted by a long standing business customer. Due to ongoing investigation litigation we're limited in the information we can share. The fraud loss was recognized in our provision for credit losses this quarter with a pre-tax impact of $123 million. The after-tax impact was $94 million.

The fraud was realized as an overdraft to two various operating accounts and charged off resulting in a recognition through our provision for credit losses. We're continuing to pursue all avenues of recovery and we will provide any material updates in our public filings.

I would also point out the impact of interest rates on our return on tangible common equity. Over the last four quarters, our other comprehensive income component of our capital has increased by $1.2 billion primarily due to lower rates.

This increase had 170 basis point negative impact on our ROTCE compared to the third quarter of 2018. Said otherwise, if the OCI remain the same, our ROCTE and notable items would have been 17.1% in the third quarter of this year.

I'll cover many of the other items on this slide in the rest of my presentation, so I'm now turning to slide 6. Our business model continues to position us well to grow relationships and loan balances. Total average loans were $92 billion, up 4% from the third quarter of last year, driven primarily by the growth in commercial and industrial loans, which were up 8%.

Linked quarter growth and average balances was also driven primarily by commercial and industrial loans, up 2%. Our growth continues to be broad based across our footprint as well as through our targeted industry verticals.

C&I growth was partially offset by decline in commercial real estate balances due to the elevated paydowns and our more cautious stance on certain loan types and markets.

Importantly, our growth continues to be more balanced with continued growth in consumer loans. We have made meaningful investments in our consumer mortgage business and completed the Laurel Road acquisition earlier this year and both are delivering results.

For Laurel Road, we originated over $500 million of loans this quarter, and our consumer mortgage business we originated $1.3 billion of loans in the third quarter more than double our volume from a year ago and up 20% from last quarter. Of this production, approximately 60% was retained on balance sheet.

Importantly, we remain disciplined with our credit underwriting and we walked away from business that does not meet our moderate risk profile. We remain committed to performing well through the business cycle and we managed our credit quality with this longer term perspective.

Continue on to Slide 7. Average deposits totaled $110 billion for the third quarter 2019, up $4.7 billion or 4% compared to the year ago period and up 1% from the prior quarter.

Growth from the prior year was driven by both consumer and commercial clients. On a linked quarter basis, the increase in deposit balances was also driven by both consumer and commercial clients, as well as elevated levels of short-term deposits from certain commercial customers.

Total interest bearing deposit costs were down one basis point from the prior quarter reflecting the lag in deposit pricing. We saw the impact of lower rates coming through late in the quarter and next quarter we would expect to see more of this benefit come through. We continue to have a strong stable core deposit base with consumer deposits accounting for 66% of our total deposit mix.

Turning to Slide 8. Taxable equivalent net interest income was $980 million for the third quarter of 2019 compared to $993 million in the third quarter 2018 and $989 million in the second quarter of this year. Our net interest margin was 3% for the third quarter 2019 compared to 3.18% for the third quarter 2018 and 3.06% for the second quarter. The decrease in net interest income from the third quarter of 2018 reflects lower interest rates, lower loan fees as well as a decline in purchase accounting accretion. These declines were partially offset by higher earning asset balances.

Net interest income decreased $9 million or 1% from the prior quarter driven by lower interest rates and loan fees. This quarter's net interest margin came in lower than expected.

Our deposit rates were higher than forecasted reflecting a slower response to interest rates and market pressures. We did see our rates move down late in the quarter providing benefit for the fourth quarter. Other factors that impacted our margin included lower loan fees costing one basis point and lower LIBOR rates relative to the change in Fed funds.

In the fourth quarter, we expect net interest income and net interest margin to remain relatively stable. Our outlook includes average interest bearing deposit rates declining by approximately 10 basis points relative to the third quarter. This also assumes an additional 25 basis point cut in rates in late October and continued growth in our loans.

In the appendix of our slide deck you can find additional information on our asset liability positioning. We’ve continued to actively hedge to reduce our exposure to declining rates, executing approximately $2.4 billion in interest rate floors in the third quarter.

Our repositioning to reduce our risk to declining rates began in the third quarter of last year and since that time we’ve entered into a total of swaps and floors of $17 billion.

Moving on to Slide 9. Key's non-interest income was $650 million for the third quarter 2019 compared to $609 million for the year ago quarter. The change from the year ago period reflects growth across most of these categories.

We reached a record third quarter in investment banking debt placement fees up $10 billion from last year. We also saw strong corporate services income, primarily driven by higher fees from derivatives, and we also saw year-over-year growth in both consumer mortgage income and mortgage servicing these.

Compared to the prior quarter, non-interest income increased by $28 million, driven by many of the same categories. Investment banking and debt placement fees increased $13 million from last quarter and we also saw growth in corporate services and consumer mortgage income.

Now, turning to slide 10. Expense management continues to be a very positive story. As we've delivered on our expense and efficiency commitments. We completed our $200 million cost savings initiatives at the end of the second quarter and the results are fully in our third quarter run rate. We have also continued to reinforce our culture of continuous improvement throughout the organization.

Third quarter non-interest expense was $939 million. This compares to $964 million in the third quarter of 2018 and $967 million in the prior quarter, excluding notable items in the second quarter. The table on the bottom left side of the slide breaks out the notable items.

Non-interest expense decreased $25 million or 3% compared to the year ago period. The year-over-year comparison reflects the successful implementation of Key's expense initiatives and elimination of the FDIC surcharge. These expenses were partially offset by the addition of Laurel Road early this year.

Compared to the prior quarter, non-interest expense declined $28 million, excluding notable items in the prior period. The decline reflects the successful implementation of Key's expense initiatives across the franchise, which drove lower personnel expense and positively impacted a number of other line items.

Moving on to slide 11. As I said previously, our provision and net charge-offs included $123 million from our previously disclosed fraud loss. Excluding the fraud loss, net charge-offs were $73 million or 31 basis points of the average total loans in the third quarter, which continues to be below our – over the cycle range of 40 to 60 basis points. On a similar basis, again, excluding the fraud loss, the provision for credit losses was $77 million for the quarter, which slightly exceeded our net charge-offs reflected continued loan growth.

Non-performing loans were $585 million this quarter, up $24 million from the prior quarter, but down $60 million from a year ago period. Non-performing loans represented 63 basis points of period-in loans compared to 61 basis points last quarter.

Non-performing assets this quarter had a temporary increase with the transfer of several loans that held for sale. We believe these credits are properly marked and are moving through the sales process, which should be completed soon.

Criticized loans and our 90 day past due loans, both declined this quarter. Overall, credit quality remains strong. Our new loan originations in both the commercial and consumer book continue to be high quality relationship business.

Turning on to slide 12. Capital ratios remain relatively stable this quarter with a Common Equity Tier 1 ratio of 9.52% at the end of the third quarter. As Beth mentioned earlier, we remain committed to our capital priorities, including returning a significant amount to our shareholders.

In the third quarter, we declared a common share dividend of $0.185 a share, up 9% from the quarterly stock dividend. We also continue to repurchase common shares with $248 million repurchased this quarter.

Turning to slide 13. Similar to our approach a year ago, we have provided fourth quarter guidance relative to our third quarter results. The guidance ranges - guidance range definitions are provided at the bottom of the slide.

Average loans should be up in the low single-digit range driven by C&I and continued growth in the consumer balances from Laurel Road in our consumer mortgage business. Average deposits should be relatively stable.

Net interest income should be relatively stable with the fourth - in the fourth quarter. This assumes a 25 basis point interest rate cut, late in October and a solid balance sheet growth and decreased deposit rates which will help provide more stability in net interest income.

Non-interest income should be up in the low single digit reflecting solid investment banking pipelines, as well as growth in our other fee businesses along with some seasonality in areas such as COLI.

We would expect non-interest expenses to be also up in the low single digit range as a result of the seasonal factors including incentive compensation target lower capital markets business.

Similar to past years, we would also expect to have a penchant settlement charge in the fourth quarter to approximate the amount taken in the same period last year.

On a credit quality we see nothing on the horizon that changes our outlook. Net charge-offs including the fraud loss should remain stable and we expect that our loan loss provision will be - will slightly exceed net charge-offs reflecting continued loan growth.

In our guidance for our GAAP tax rate will be approximately 16% [ph] Overall, we expect a good finish to the year despite some headwinds from rates and signs of potentially slower economic growth.

Our clients have become more cautious that we continue to see good engagement and expect to grow through offering our targeted clients are attractive on an off-balance sheet alternatives.

Overtime, we’ve reduced our net cash interest rate sensitivity and we remain diligent in our underwriting and risk management. And we’ll continue to manage expenses through our continuous improvement efforts, while investing a portion of the savings back into the business.

Finally we expect to achieve our long-term targets and I believe over time our market valuation will reflect our progress and improve results. I will now turn the call back over to the operator for instructions for the Q&A portion of the call. John?

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] First in line we have Scott Siefers with Sandler O'Neill. Please go ahead.

Scott Siefers

Good morning, guys. Thanks for taking the question. I guess first well congratulations on the succession to both of you guys. So maybe top - first question is on the tax rate. I think it came in a little lower-than-expected this quarter. It looks like the guide is perhaps for slightly lower one next quarter as well.

Can you maybe talk to the nuance of that and if that's the kind of thing that would sustain itself into 2020 as well?

Don Kimble

Yes. As far as the third quarter what you're seeing in the reported tax rate is the impact of the fraud loss, and so that really is reported on an incremental basis. So if you would adjust for that our effective tax rate was a little north of 16%.

We would expect the same type of range for the fourth quarter which reflects the benefit of credits that are available to us and also the impact of the updated outlook for pretax earnings as well.

Scott Siefers

Okay. Perfect. Thank you. And then just I guess a top level. Now that you've hit the top end of the efficiency range, do we think that's a number that you guys will be able to sustain into coming periods or improve upon or how were you thinking about that dynamic as you look into next several quarters?

Don Kimble

Yes. Long term we clearly want to operate within that range. We think that's appropriate given our business mix that we have here at Key. And it's something that we feel is an indication of us being able to manage our overall cost structure efficiently and effectively.

As far as, next year we're still expecting to manage for the full year in that range. Now you could see quarters we're like the first quarter of each year tends to be a little bit higher than through the rest of the year. But that would be our objective as well going forward.

Scott Siefers

Okay. Perfect. Thank you guys very much.

Operator

Next in the line we have Ken Zerbe with Morgan Stanley. Please go ahead.

Ken Zerbe

Hey, thanks. Now, if I heard correctly I think you said 10 basis points of deposit house reductions in the fourth quarter including the October cut. I guess presumably let's call that a 20% deposit beta given the 50 basis point reduction.

Can you just talk about like your ability to reduce deposit costs? Just in terms of your competition we hear it's very slow of other banks bringing down their deposit costs. I'm just kind of wondering at what point does that actually start to accelerate? Thanks.

Don Kimble

Yeah. Sure. We would probably define it as stronger than a 20% beta because that rate decline doesn't occur till late in October, and so the average throughout the quarter would suggest something probably in the 30% beta. Longer term we would to see that in the 40% to 45% range as far as reaction to rates.

You're absolutely right; we are seeing competitive pressures, especially consumer side that is resulting in some of those deposits rates being a little stickier than what we would've expected initially. We still think there's plenty of opportunity for us to manage that down and to be in that 40% to 45% beta to allow us to have more stability in the margin prospectively.

Ken Zerbe

All right. Great. And then could you provide an update in terms of the impact to CECL?

Don Kimble

Yeah. Sure. We'll provide additional disclosure in our Q. But what we have talked about is that for commercial loans, we really don't see an increase from the incurred loss method to CECL. And on the economic outlook you could actually see a slight decline in commercial.

Now offsetting that on the consumer side that we would expect the CECL reserve to probably be about three times the level that we're seeing on the incurred loss method. And that really reflects more of a life of loan type of loss expectation as opposed to today. You probably have about a year and a half or so of charge-offs included in the consumer categories.

And so luckily for us our reserves are only about 15% consumer and about 85% commercial. So the relative impact us should be fairly modest compared to some of the early indications we've seen from some of the other companies.

Ken Zerbe

All right. Great. Thank you.

Operator

The next question is from John Pancari with Evercore. Please go ahead.

John Pancari

Good morning. Just want to get some additional color of what you're seeing in terms of loan demand. I know that you've indicated that the pipelines are solid, but obviously we've seen a little bit of pullback in ISM and a little bit of pullback in CapEx activity. So, I just want to see if we could talk a little bit about what you're seeing on the commercial side?

And then what does that mean in terms of how you're thinking about your broader loan growth when you look at 2020? Could it be near the 4% that you're looking at for '19? Thanks.

Chris Gorman

John. Its Chris. Good morning. Our loan growth this quarter was as a result of our continued focus and strength of our commercial businesses. What is differentiated now for Key vis-à-vis the past are the new engines that we have on the consumer side and as you've heard Don talk about the growth we have in mortgage and also now we have Laurel Road. So those will be opportunities for us to kick-in loan growth as we go forward.

We anticipate on the commercial side, utilization being relatively flat. We have seen - as both Beth and Don mentioned our customers are cautious. But having said that, we're still out there talking to our customers, serving our customers, the pipelines remains strong, but I think clearly there are some challenges out there.

John Pancari

Okay. Thanks all right. That's helpful. On the - separately on the credit side, I was just wondering we could get a little bit more color on the non-performers. I know that NPLs were up a bit for the quarter despite the higher charge-offs even when you exclude the fraud.

So I just wanted to get a little bit of color on what drove the inflows into non-accruals in the quarter? And what - and also if you have any detail on how criticized assets trended for the quarter? Thanks.

Don Kimble

Sure. As far as the change in the NPLs and the inflows, we did have three commercial credits that moved into non-performing status this quarter. They were criticized loans before and the status was changed from accruing to non-accruing. And those three loans totaled $100 million, and so that was isolated those individual credits.

As we've said before you can have episodic type of issues or things that pop up that we believe are temporary. In connection with our nonperforming loans we also - as we mentioned transferred a pool of assets, which included some commercial and some residential real estate to held for sale, which on the process of sale we expect to close quickly and bring that level down.

As far as the charge-offs, they came in at 31 basis point this quarter, I think they were 28 or 29 basis points last quarter. I think you will see some variability in that range but I think in the low 30 basis point range is probably a good outlook going forward and reflects a very stable and a very stable and a very strong credit quality overall.

As far as criticized and classified, I'd say they're relatively stable and maybe even down a little bit linked quarter. But very, very stable as far as the overall credit quality from that perspective.

John Pancari

Okay. Thanks, Don. Appreciate the color.

Operator

And next we'll go to Peter Winter with Wedbush. Please go ahead.

Peter Winter

Good morning.

Don Kimble

Good morning.

Peter Winter

You guys had very nice momentum on the expenses, particularly driven I guess by the reduction in headcount. I'm just wondering, do you think you can drive expenses lower further in 2020?

Don Kimble

Yeah. We're always going to have a continuous improvement mindset. And what we would typically target would be to keep expenses relatively stable and allow us with that to make investments back in the business to grow the top line. We're very focused on driving positive operating leverage and we continue to expect to deliver that this year and we'll expect to do that again next year as well.

And so these continues improvement opportunities allow us to manage our expenses more efficiently, more effectively and it includes ongoing efforts like workflow redesign, branch consolidations and other things like that that we just think are part of our ongoing business model and it's going to be critical for us to continue those efforts to make sure that we have the capacity to reinvest back in the business.

Peter Winter

Actually a follow-up on Scott's question about the tax rate. Looking to 2020, would it go back to that more normal range of 18% to 19%?

Don Kimble

We'll provide more guidance in January as far as the tax rate outlook. I think that there's a number of factors that influence that one is the level of credits that are available to us that we continue to be a active participant. Some of the alternative energy sources which allows us to realize some tax credits associated with that.

And so part of our outlook will be determined based on what we see as the market for those credits, but also the impact of the overall pre-tax earnings going forward. And so we'll provide more outlook there. But I'd say that you'll probably see some increase compared to the current year because of some of the noise that are in this year's numbers.

Peter Winter

Thanks very much.

Operator

Our next question is from Ken Usdin with Jefferies. Please go ahead.

Ken Usdin

Hi, good morning. Hey, Don, just a follow up on that hope that you can still get inside the 54, 56 for next year on the cash efficiency ratio. Obviously, we're seeing the headcount reductions. You just talked about some of the other efficiency improvements but the Street obviously still modeling way above that?

Perhaps you can help us address just where you see the delta? Is it just that we're not anticipating as much of a reduction in the overall cost base as perhaps you guys are seeing? Any color just in terms of maybe how that cadence of expenses might go would be helpful? Thank you.

Don Kimble

Sure. And I think you've already hit on one of the surprise. I think that our expenses did come in lower than what The street was expecting for us this quarter and it really serves the foundation for us going forward.

And so we would expect to, as I said be in a position so we can continue to manage that expense level to be relatively stable and continue to grow revenues. And so that's the critical part for us. And I think as we do that, we should be able to continue to manage that efficiency ratio into the range for us over time here.

Ken Usdin

Okay. Got it. And then secondly just can you talk about the balance sheet protections and slide 17 is very helpful again. Just the cadence of how the forward starting swaps are going to move on? And any color that you can provide in terms of where the new floors and existing floors are going - are the strike prices are? Thanks, Don.

Don Kimble

Sure. We did add $2.4 billion of primarily floors this past quarter. And so as you highlighted that we’ve seen a lot of investments made there since the third quarter of last year.

We’ve got about $3 billion worth of floors starting swaps that most of which will kick in here for us in the fourth quarter. And just to put that in perspective, we're going to have a received fixed-rate of upper 2% to 90 range as opposed to. Today it would be a much lower resulting, a starting point for that received fixed-rate.

As far as the floors, it really provides this protection within a plus or minus 100 basis points range as far as the current flows. And so we did see some benefit in the third quarter from those floors and it's more provided as far as a additional protection for us in case rates do go down further than what we would expect. And so we're using that more as a protection as opposed to a revenue source for us.

Ken Usdin

And one final one just - are you done with the program ads like is this where you want to be in terms of that swaps and floors math that you now have ready to start?

Don Kimble

We would like to continue to increase our derivatives offset some of the interest rate risk that we still have in the portfolio. So I think that when we've talked about $2.4 billion of new floors this quarter, we would expect to see that kind of similar pace going forward combination of floors and swaps.

And the determination as to whether we would do the swaps or floors would be based on how does the forward curve compare with our internal assessment as to where rates are going.

And so we think it's important to continue to position us to be even more interest rates neutral and we'll continue down that path.

Ken Usdin

Got it. Okay. Thanks, Don.

Operator

Our next question is from Steven Alexopoulos with JPMorgan. Please go ahead.

Steven Alexopoulos

Hey. Good morning, everybody.

Don Kimble

Good morning.

Steven Alexopoulos

I wanted to start first to follow-up on the comments Don, that you could hold expenses flat in 2020. What are your expectations for the headcount? You think on an overall basis you can still manage that lower next year?

Don Kimble

I would say that our efforts continue to be focused on a culture around continuous improvement, and so, we believe that there're ongoing opportunities for us to right size some of the workflows we have to throughout the organization. And as we've talked before in the past, we would expect to continue to see our branch count come down, and we've said it's 2% to 3%.

And each one of those could have some impact on staffing, but the staffing numbers themselves aren't as critical to us as the efficiencies we gain. And we think there's other ways that we can leverage third-party vendors and leverage some of the technology spend that we make that will help drive some of those efficiencies that won't be as FTE dependent as was what we've experienced over the last year

Steven Alexopoulos

Okay. That's helpful. And then when we look at the fourth quarter, it's typically your strongest quarter for IB and debt placement fees. Look at loans held for sale, they came down a bit. I know it's typically our leading indicator. Does that imply maybe a bit softer quarter for debt placement fees? I don't know what the pipeline looks for 4Q.

Chris Gorman

So, Steve, its Chris. Our fourth quarter pipeline is, I would characterize as strong. So sometimes there is a correlation as you look at what's held for sale and what's not. That depends a lot on mix. As we look at our pipeline, I would characterize our pipeline is strong going into the fourth quarter from investment banking and debt placement fees.

Steven Alexopoulos

Okay. Got you. And then, if I could sneak one more in. Don, just looking at the appendix in the slide where you're calling out the year, basically effectively neutral to rates. Now, does this imply even beyond 4Q the NIM should be relatively flat, is that basically the assumption.

Don Kimble

That's our expectation at this point time. I'd say that, what the slide would basically say as, we're neutral to the forward curve, and so if there are variances to that for curve, it could have an impact on near term rates.

But that's our whole objective, as far as managing to more of an interest rate neutral position as to have as much stability as we can in that net interest margin and help drive the revenue growth from there.

Steven Alexopoulos

Okay. Thanks, and congratulations Beth. Thanks for taking my questions.

Don Kimble

Thank you.

Beth Mooney

Thanks, Steve.

Operator

Next we go to Gerard Cassidy with RBC. Please go ahead.

Gerard Cassidy

Good morning, everyone.

Don Kimble

Good morning, Gerard.

Gerard Cassidy

Don, you mentioned about the deposit rates didn't start to move down until the end of the quarter following the last rate cut, there was somewhat of a delay. Do you think on future rate cuts, there'll be the same type of delay or is this momentum that you're seeing on lower deposit costs will carry through into the next rate cut.

Don Kimble

I think, there were some situations this quarter that were unique, that on the consumer front we continue to see rates go up in July and even in the August, the consumer side and some of that was from promos that were in place and other things like that.

I would say, going forward, we wouldn't expect to see the same type of delay. We were a little surprised to be honest, though, that we thought that the markets would move down quicker than what they did and they didn't.

But as I mentioned, for example, in the promos, we've got about $2 billion each quarter of money market deposits that are at a promo rate that will roll off. And so, that will also help accelerate some of the deposit betas on the retail side that we wouldn't have available to us on a quote.

Gerard Cassidy

Very good. And then, Chris, on Laurel Road, can you share with us - obviously, it seems to be going well, but what type of expansion, you can take from what you're learning from Laurel Road into other consumer products?

Chris Gorman

Sure. Well, you're right Gerard. We've been very pleased with Laurel Road. First thing we wanted to do is sort of run the place that they had, which was really a complete digital approach to the refinancing of loans principally for doctors and dentists. And as you saw in this quarter we originated about $0.5 billion in loans.

The next phase of that is going to be our ability to similarly provide mortgage. So as you can imagine we have in a digital format all the information we need for sort of Phase II which is to provide a digital mortgage to those customers, and further we can leverage Gerard that technology and that approach across all of Key.

And then lastly what it would give us the opportunity to do at some point would be create an infinite a strategy around a targeted segment which is obviously consistent with how we go to market.

Gerard Cassidy

Very good. Thank you.

Chris Gorman

Thank you.

Operator

Next we'll go to Mike Mayo with Wells Fargo Securities. Please go ahead.

Mike Mayo

Hi. We’re going to be in the transition from Beth to Chris, can you just talk about how that transition works? Beth if you'll be staying around in any capacity once Chris takes the reigns? Why Chris was selected?

And Chris maybe how you might think about things differently? I noticed it's a little unusual, but also it's appreciated to have both of you on the call and a smooth transition?

Beth Mooney

Good morning Mike I’ll start with - as you know Chris has been with our company since the last 1990s. He’s plan our Corporate Bank and very successfully developed that strategy on our behalf to include the what I call a distinctive corporate investment banking capability was the head of our merger and the last couple of years, he’s been our President - Vice Chairman and President of Banking.

We also have at Key what I think it's a great and talented and very diverse team with good momentum. As of May 1 next year, I’ve been with the company 14 years and I will have been our CEO for 9 years.

So I think there is value in knowing when it's an appropriate time to work on an orderly succession. And as we said in our comments, I will be our Chairman and CEO till May 1, at which time I will retire.

And no, I will not have ongoing responsibilities at Key, I will fully retire, and at that time Chris will become our Chairman and CEO. And as I've said, I'm excited and fully confident in the team in the future under Chri’s leadership. And I too have chapters to write and things to do and I think this is an example of what a well orchestrated and appropriate succession looks like.

Chris Gorman

Mike, the only thing I would add to that is, it's obviously an honor and a privilege to lead what I think is just a great team. I think we have a really, really good and defined strategy that we laid out at Investor day, last October.

The whole notion of targeted scale, how a company of our size can be really effective, when we target who we want to be relevant to and how we want to be relevant? As it relates to the transition, Beth and I work very, very closely together. And I am confident it will be an absolutely seamless transition.

And as we go forward, while we have our strategy in place, the reality is our industry is changing and changing quickly. And I think we as a team, that can stay out ahead of it and position us for continued success.

Mike Mayo

And then just one follow-up, maybe looking in the past and in the future as it relates to scale, because you mentioned scale and the scale to compete in an era where the largest banks spend a lot more in technology and marketing and they're expanding into your markets.

So just how do you think about your competitive positioning over the next 5, 7 years? Beth, you've obviously held to the current strategy, made one acquisition. Will the acquisition appetite maybe increased or what's your thought process?

Don Kimble

So, as we look forward, as I mentioned, I think Mike, for a bank our size to try to be all things to all people is not the strategy, the strategy for us has always been to figure out who we can be relevant to and make the appropriate investments, whether it's people, processes, technologies.

And if you think about the investments we've made, things like HelloWallet, which is digital wellness, things like Laurel Road, things like Bolster, which is in the commercial side. We think with proper focus, we have all the capabilities that we need and bandwidth that we need to make investment continue to grow the business.

Mike Mayo

Thank you.

Operator

Next we'll go to Saul Martinez with UBS. Please go ahead.

Saul Martinez

Heym good morning. Congratulations Chris on the new role and Beth on all of your accomplishments. So I wanted to follow-up a little bit on the deposits commentary. Don, you mentioned that you were surprised the market didn't go even lower. Why do you think that is?

And is it the version versus your expectation coming from the consumer side because you mentioned the promo rates and the pressure related to that or is it also occurring on the commercial side?

And if you can just talk a little bit about your expectations for a 40% to 45% beta on the way down, I would think most of that is on the commercial side versus the consumer side, but if you can comment on that?

And whether you think there are risks to being aggressive in commercial pricing? Does it hurt your competitive position at all for some of your commercial clients?

Don Kimble

Very well. I'll try to hit all those topics and if I've missed some, please help provide some more guidance.

Saul Martinez

There a few questions in that, I…

Don Kimble

That's great. And on the consumer front, as we were going through rates moving up, consumer portfolio lagged and lagged significantly, and the deposit betas, they were extremely low. And so it may have been false hope or expectations on my part to see a faster reduction as far as the initial reaction on some of the consumer rates. But we do think they will come down over time and we will see the market to move down.

And I think we're seeing that this quarter with a lot of the banks showing pressure as far as deposit rates and very few having deposit betas on the way down that probably would've been expected or anticipated. So we believe we will see that come true.

As we mentioned before, at the end of September, we were seeing some of the rates come down and seeing some of the actions put in place. It probably just curdled a little slower than what we would've expected.

On the commercial side, the commercial deposits as a general have more deposits that are indexed to the changes in interest rates. So for us, that tends to be more indexed to Fed funds as opposed to LIBOR. And this quarter, LIBOR impacted the loans and it was a much bigger decline than what the Fed funds rate declines occurred and therefore impacted our cost of funds, and so as those things stabilized, we should see even further reductions on the commercial side.

One of the things we try to manage all as it they were flushed with the liquidity right now. We've had an internal target of having an LCR ratio somewhere around 110%. This last quarter, we need up north of 145%, and so we have a lot of excess liquidity, and we would hope to try to manage that and manage some of the rates down more in a leading position that would allow us to recapture some of that deposit beta that we missed out here in the third quarter.

Saul Martinez

Got it. Do you feel pretty good about the 10 basis points then in the coming quarter?

Don Kimble

We feel good about the actions we're taking, and we feel good about achieving that in the fourth quarter. Correct.

Saul Martinez

Just to switch of gears, can you remind us how much Laurel Road contributed to the cost base? I want to say it was $30 million run rate, but is that right? And has there been any impact on revenue thus far?

Don Kimble

What we talked about as far as the acquisition was about a $20 million per quarter run rate as far as expenses. And the current expense levels are just a little bit less than that because of some of the efficiencies we've already been able to achieve with the integration there.

We haven't disclosed revenues per se, but I would say we're off to a very strong start. That third quarter, we had over $400 million of originations and - excuse me, in the second quarter, we had over $400 million and third quarter, we had over $500 million of originations.

And to put that into perspective, we just talked about $1.2 billion would be in our target for a full year's worth of originations. And so in those first two quarters we had over $900 million and so we're off to a very good start there, very pleased with the credit quality of the originations. FICO scores north of 770 and a strong income and very focused on advanced degree medical profession. And so we’re very excited about that and look forward to be a strong growth engine for us.

One of other pieces we talked about for Laurel Road though too is it that some of the tools and capabilities and the ability to understand how to digitally originate new business and relationships is something that we're really just now starting to lever throughout the entire Key franchise. And we think that will be a huge benefit for us that we haven't even started to realize yet at this point.

Saul Martinez

Got it. And just one final one, just a clarification. The pension charge in the fourth quarter that is not built into the guidance that's a non-core item?

Don Kimble

We could characterize that as a notable item each quarter. And so that's correct.

Saul Martinez

Okay. Just wanted to make sure. Thank you.

Don Kimble

Thank you.

Operator

Our next question is from Marlin Mosby with Vining Sparks. Please go ahead.

Marlin Mosby

Thanks. Wanted to ask you a little bit about credit in a backward way, you had $123 million charge-off relating to this one loan. Does that represent the lumpiness in the portfolio because that took a charge-off from 30 basis points all the way up to 80? So you go from below your range to above your range with one loan. So is that just a reflection of the exposure you have because of the commercial focus like you were saying earlier in the loan portfolio?

Don Kimble

Marty as far as the $123 million, it was a fraud loss, and as we noted briefly that the fraud loss came through because of the fraud resulted in a net overdraft position of several of the operating accounts from this entity.

And as a result of those being considered overdraft the reporting requirements would say that that should be treated as a charge-off, and so we really consider this to be a true fraud loss and not reflective of a lending relationship. There were no loans outstanding to that entity that resulted in this fraud.

Marlin Mosby

Got you. Thanks. And then, Beth, wanted to congratulate you. I mean you've evolved KeyCorp into I think a much better company over your tenure coming out of financial crisis and now - Chris can now take on and continue to build from here.

I wanted just to – not to be too personal but when you think about your decision in a sense of retiring and not maybe just becoming Chairman and our chairperson and going through that process. How did you think and what's kind of weighing why now for you individually, because I think that was a question I heard a lot from investors because I kind of get caught off guard from here.

And as you think about the strategic decisioning around moving on, it's hard for a person to a new role to do that. And to think about what's the exit strategy for the overall company long term. So if you can just kind of address those two issues that'd be very helpful I think for folks to just have a better feel for why this is happening right now.

Beth Mooney

So, Marty I'd be delighted to. As I said, I think there is a lot of value and thinking as much about when and how is the right time to build succession and step down from a role like CEO and Chairman, as there is in the energy you put into it when you first get the opportunity.

And I believe that with nine years in Chair, as our CEO, as of May 1st, if you recall I've been a two-term President. And I will be 65 years old next year and I believe that remaining our Chairman and CEO till May 1st is the appropriate thing to do.

Chris and I, as he has indicated and I've said earlier are very much working on a seamless transition and we've obviously worked together for many, many years. The team is solid, mature, well seasoned. The company has a lot of good momentum and this is the appropriate time for the company, the appropriate time for me and there's always chapters to write. And I look forward to the things that I can do civically in my continued professional commitments as well as having a little more time for family, friends and travel.

And after May 1st, again from a thorough discussions with our board as we went through this succession process planning, believe the appropriate thing to do is that Chris will become our Chairman and CEO and that was done with much consideration with our board about what is the right leadership structure for Key, and yes, I will fully retire as of May 1st.

Marlin Mosby

Well, best of luck and congratulations on a job well done.

Beth Mooney

Well, Marty I appreciate that. As I had said in my opening remarks, this has been a absolute privilege of my career. And I appreciate your comments that I think the ultimate test as you leave it better than perhaps you found it.

Operator

Our next question is from Brian Foran with Autonomous Research. Please go ahead.

Brian Foran

Hi, good morning.

Beth Mooney

Good morning.

Brian Foran

Maybe just on CECL I hear you that the overall impact day one it's not that huge. But this is – just the 3x on consumer and as you're growing consumer into next year like $1 billion a quarter. Do we have to start thinking about like even though the cash flows haven't changed and the underlying performance hasn't changed just building in like a $20 million reserve for growth type placeholder you know just from the concept of running with a much higher reserve to loan on your consumers and every time you put a loan on the books you got to fully upfront that reserve built day one.

Beth Mooney

You're absolutely right as far as going forward the new volume coming on the books will clearly have a higher reserve than we did historically under the over incurred loss method. And we'll provide more clarity on that as we get into the first quarter outlook at the end of our fourth quarter call.

I don't know I'd - can hold a $20 million placeholder yet but that will provide some more color. But you're absolutely right. The initial provision required for a new loan origination is higher under CECL for consumers than it is under the incurred loss method.

Brian Foran

Got it. And then on the efficiency, I mean, I almost hate to ask this but as long as I've been doing this I continuously screw up cash versus GAAP efficiency. Does – is the so it was 160 basis points difference this quarter is that like a stable relationship and so for those of us who have put a GAAP efficiency in our model, the 54 to 56 plus 160 bps is a good benchmark for what you're thinking on a GAAP basis?

Don Kimble

Well, essentially the difference between the cash efficiency and the GAAP is the impact of intangible amortization. And so, going for the intangible amortization should continue to decline and so that gap should narrow.

Brian Foran

Got it. So maybe more like 100 to 150 next year.

Don Kimble

Yes.

Brian Foran

Perfect. Well, thank you all and congratulations both Beth and Chris.

Beth Mooney

Thanks, Brian.

Operator

Next we'll go to Brian Klock with Keefe, Bruyette, Woods. Please go ahead.

Brian Klock

Good morning, everyone.

Don Kimble

Good morning.

Beth Mooney

Good Morning.

Brian Klock

And again, I guess, congratulations to everyone and Beth, best of luck to you on your future endeavors.

Beth Mooney

Thank you very much. I'm looking forward to.

Brian Klock

All right. And just a real quick follow up for you Don. I know you talked about a lot of the active hedging you guys have put in place and you got some more forward starting swaps kicking in here, later this quarter into the first quarter.

So the expectation at the NIM could still compress here in the fourth quarter before being stable? I guess into 2020 or do you think there's more stability here into the fourth quarter from the hedging that you guys have put into place.

Don Kimble

We will see a clear benefit from the hedging occur in the fourth quarter. Our outlook is for a stable net interest margin and so we would expect that to occur that - I think, that a good portion of that is from the deposit repricing and the benefit of the hedging, but we'll also see a little bit of benefit in that.

Our look says that we'll have low single-digit growth in loans and relatively stable deposits. And so, we should see that liquidity level in the fourth quarter come down just a little bit, which will also provide some reinforcement there as well.

Brian Klock

Got it. That's helpful. Thank you very much.

Don Kimble

Thank you.

Operator

We'll go to Scott Siefers with Sandler O'Neill. Please go ahead.

Scott Siefers

Hey, guys. I just wanted to ask on the fees for the third quarter, you had the 15 million in securities gains which is a little unusual for KeyCorp. Is that something - like, are you going to have additional securities gains going forward or as we think about. And, I guess, the genesis of the question is, as we think about the fourth quarter guide, that's off the reported $650 million base, right?

So maybe you could talk a little bit more about sort of the puts and takes on fee momentum into the fourth quarter. Sound like the investment banking pipeline is solid, which should be helpful, of course, but maybe some of the other things that would drive growth off that base as well.

Don Kimble

Scott, we didn’t have any security gains during the quarter. We did have a gain from the sale of some - an investment in a partnership we participated in, but I'm - I apologize, I don’t know where you're picking up the $15 million in security gains with all that.

Scott Siefers

I’m sorry, it's just in the footnote on the slide 17.

Don Kimble

Okay.

Scott Siefers

Three and nine months totaled $15 million. We can talk about that offline.

Don Kimble

Good. We’ll go through that, I apologize. But that probably includes the gain there along with the gain on the securitization transaction we had from the sale of some of the Laurel Road loans but we'll follow up with you on that as well.

Scott Siefers

Okay. PERFECT. Okay. So either way, though, the guide is indeed off that $650 million base, right?

Don Kimble

I would say that the $650 million is core and our guidance would be based or included to that, there from the reference for the $650 million, so we expect to see growth from there going forward.

Scott Siefers

Okay. Good.

Don Kimble

Okay. Thank you.

Scott Siefers

That sounds…

Operator

And with no further questions, I'll turn it back to the company for any closing comments.

Beth Mooney

Again, we thank you for participating in our call today. And if you have any follow up questions you can direct them to our Investor Relations team at 216-689-4221. That concludes our remarks and thank you again for your time this morning,

Operator

Ladies and gentlemen that does conclude your conference. You may now disconnect.