Goldman Sachs Group (GS) Q2 2017 Results - Earnings Call Transcript

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Q2: 07-18-17 Earnings Summary

SEC *10-Q*

EPS of $3.95 beats by $0.56 | Revenue of $7.89B (-0.57% Y/Y) beats by $414.7M

Goldman Sachs Group Inc. (NYSE:GS) Q2 2017 Results Earnings Conference Call July 18, 2017 9:30 AM ET

Executives

Dane Holmes - Head of IR

Martin Chavez - CFO

Analysts

Glenn Schorr - Evercore ISI

Michael Carrier - Bank of America Merrill Lynch

Guy Moszkowski - Autonomous Research

Jeff Hart - Sandler O'Neill

Betsy Graseck - Morgan Stanley

Brennan Hawken - UBS

Jim Mitchell - Buckingham Research

Steven Chubak - Nomura Instinet

Gerard Cassidy - RBC Capital Markets

Al Alevizakos - HSBC

Brian Kleinhanzl - KBW

Operator

Good morning, my name is Dennis and I will be your conference facilitator today. I would like to welcome everyone to the Goldman Sachs Second Quarter 2017 Earnings conference call. This call is being recorded today, July 18, 2017. Thank you.

Mr. Holmes, you may begin your conference.

Dane Holmes

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

Today's call may include forward-looking statements. These statements represent the firm's belief regarding future events that by their nature are uncertain and outside of the firm's control. The firm's actual results and financial condition may differ, possibly materially, from what is indicated in those forward-looking statements. For a discussion of some of the risks and factors that could affect the firm's future results, please see the description of risk factors in our current annual report on Form 10-K for the year ended December 2016.

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

Our Chief Financial Officer, Marty Chavez, will now review the firm's results. Marty?

Martin Chavez

Thanks Dane, and thanks to everyone for dialing in.

I'll walk you through the second quarter and first half results then I'll be happy to answer any questions. In the second quarter, we produced net revenues of $7.9 billion, net earnings of $1.8 billion, earnings per diluted share of $3.95 and an annualized return on common equity of 8.7%.

Taking a step back to review our year-to-date results, we had firmwide net revenues of $15.9 billion, net earnings of $4.1 billion, earnings per diluted share of $9.10 and a return on common equity of 10.1%.

As you can see, the first six months of 2017 reflected improved performance. We were able to achieve this despite what continues to be a challenging operating environment in certain businesses. Our revenues were up more than $1.6 billion or 12% compared with the first half of last year.

Meanwhile expenses were up only 6% demonstrating the positive operating leverage that is embedded within our operation. Despite a difficult backdrop for our FICC business, the firm grew pretax margin by 340 basis points, versus last year and our ROE increased 260 basis points.

The improvement stems from having a diversified set of leading global businesses. Weakness in FICC particularly in commodities was offset by stronger results in investing in lending, investment management and underwriting.

As all of you are aware, many of the themes that we discussed during the first quarter continued into the second, rising market values and low volatility. On one hand, rising market prices were supportive of capital markets activity, investment management performance and our investing and lending activities.

We recorded our third best quarterly revenue performance in debt underwriting, reflecting our multiyear effort to improve our relative positioning with our clients.

Another area of strength is investment management, where we posted record management and other fees and assets under supervision and investing and lending generated $1.6 billion of revenues in the quarter with net interest income within debt securities and loans reaching more than $400 million.

On the other hand, low levels of volatility sequentially lower in several fixed asset classes, negatively affected the FICC environment. The current backdrop has been particularly challenging for our FICC franchise creating headwinds in areas that are core strength of the firm.

For example, we are a market leader in commodities, but it was a challenging environment on multiple fronts. In addition, our clients place significant value on the firm's long-standing commitment to market making as well as our strength in derivatives. The client activity levels understandably declined given the low volatility environment.

With that as a broad overview, let's now discuss individual business performance in greater detail. Investment banking produced second quarter net revenues of $1.7 billion up slightly compared to the first quarter. Our investment banking backlog increased since the end of the first quarter.

Breaking down the components of investment banking in the second quarter, advisory revenues were $749 million, roughly flat for the first quarter. Year-to-date Goldman Sachs ranked first in worldwide announced and completed M&A.

We advised on a number of important transactions that were announced during the second quarter, including C. R. Bard's $24 billion sale to Becton Dickinson. Amazon's $13.7 billion acquisition of Whole Foods and DuPont Fabros Technology's $7.6 billion merger with Digital Realty Trust.

We also advised on a number of significant transactions that closed during the second quarter, including Syngenta's $43.6 billion sale to ChemChina, HPE's $13.5 billion spinoff and merger of its enterprise services business with Computer Sciences and Private Bancorp's $5 billion sale to CIBC.

Moving to underwriting, net revenues were $981 million in the second quarter up 4% on a sequential basis. Equity underwriting revenues were $260 million down 16% quarter-over-quarter due to lower follow-on offerings.

Debt underwriting revenues of $721 million reflected continued strength across all products and were up 13% relative to the first quarter. During the second quarter, we actively supported our client's financing needs participating in QUALCOMM's $11 billion bond offering in support of its acquisition of NXP.

Intrum Justitia's €3 billion bond offering in support of the combination with Lindor and Banco Macro's $766 million follow-on offering.

Turning to institutional client services, which comprises both our FICC and equities businesses; net revenues were $3.1 billion in the second quarter down 9% compared to the first quarter.

FICC client execution net revenues were $1.2 billion in the second quarter down 31% sequentially as volatility and client conviction remained low and led to weaker client activity quarter-over-quarter. All of our businesses produced lower net revenues quarter-over-quarter.

Rates was down significantly. Credit, mortgages and currencies all declined. Across many of these products, volatility trended lower in the quarter and clients were less active. Commodities was also significantly lower and was our worst quarter on record.

Not surprisingly given the results, it was a difficult quarter on all fronts. The market backdrop was challenged. Client activity remained light and we didn't navigate the market as well as we aspire to or as well as we have in the past. Nevertheless, the firm remains committed in every way to help our clients manage their commodity risk.

Now moving to equities, which include equities client execution, commissions and fees and security services, net revenues for the second quarter were $1.9 billion up 13% sequentially. Equities client execution net revenues of $687 million were up 24% compared to first quarter due to stronger results in cash products.

The business continued to operate in an environment with global equity market strength. Commissions and fees were $764 million up 4% versus the first quarter as volumes increased modestly. Security services generated net revenues of $441 million up 15% quarter-over-quarter due to seasonally stronger client activity.

Turning to risk, average daily VaR in the second quarter was $51 million down from $64 million in the first quarter, the byproduct of lower volatility levels.

Moving on to our investing and lending activities collectively, these businesses produced net revenues of $1.6 billion in the second quarter. Equity securities generated net revenues of $1.2 billion reflecting sales, corporate performance and gains in public equity investments.

Net revenues from debt securities and loans were $396 million and as I mentioned before, included more than $400 million of net interest income.

In investment management, we reported second quarter net revenues of $1.5 billion. This was up 2% from the first quarter, primarily as a result of higher management and other fees, which were a record for the quarter.

Assets under supervision increased $33 billion sequentially to a record $1.41 trillion. The increase primarily reflected $23 billion of net inflows in connection with the acquisition of a portion of Verus Investors and $17 billion of net market appreciation. This was partially offset by net outflows in liquidity products.

Now let me turn to expenses; compensation and benefits expense for the year-to-date, which includes salaries, bonuses, amortization of prior year equity awards and other items such as benefits was accrued at a compensation to net revenues ratio of 41%.

This is the lowest first half accrual in our public history and a 100-basis points lower than the accrual in the first half of 2016. As we discussed last quarter, the reduction in the accrual rate reflects the completion of the nearly $900 million expense initiative that we announced last year. Second quarter non-compensation expenses were $2.1 billion down slightly from the first quarter.

Now I'd like to take you through a few key statistics for the second quarter. Total staff was approximately 34,100 unchanged from the first quarter. Our effective tax rate for the year-to-date was 19.1%. If you exclude the tax benefit related to the settlement of equity awards, our effective tax rate for the year-to-date would have been roughly 29%.

Our global core liquid assets ended the second quarter at $221 billion and our balance sheet and level III assets were $907 billion and $21 billion respectively. Our common equity Tier 1 ratio was 12.5% under the Basel 3 advanced approach on a transitional basis and 12.2% on a fully phased-in basis.

It was 13.9% using the standardized approach on a transitional basis and 13.5% on a fully phased-in basis. Our supplementary leverage ratio finished at 6.3% and finally we repurchased 6.6 million shares of common stock for $1.5 billion in the quarter.

For the four quarters CCAR cycle for 2016, we provided shareholders with nearly $7 billion of capital through share buybacks and common stock dividends. In terms of this year's CCAR test, the Federal Reserve Board did not object to our plan, which includes the potential for share repurchases, an increase in our common stock dividend and the issuance and redemption of capital securities. We are pleased with this outcome and believe we have flexibility to manage our capital going forward.

Now for some brief summary comments. The first half of 2017 provided two important reminders. First is the value of having a leading diversified franchise. Despite a difficult first half of 2017, where one of our major businesses FICC, we posted 12% year-over-year revenue growth and a 10.1% return on common equity.

In addition, we were able to produce $9.10 of earnings per diluted share. We benefited from leading positions in many of our businesses and while their relative performance may vary in any individual quarter, their collective value has been central to our outperformance over the long-term.

The second reminder is the ongoing and long-term benefits associated with being a prudent manager of both cost and capital. Over the last several years, we've been looking for ways to operate more efficiently. This includes shifting our organizational footprint to different locations such as Salt Lake City where we now have more than 2,300 people.

It is meant leveraging technology to improve internal productivity and find engagement. It has also meant returning more than $35 billion of capital since the beginning of 2012 and in the process creating our lowest ever share count.

This has positioned the firm to provide more operating leverage to shareholders and it has also given us the capacity to make strategic investments such as markets and expand our investment management business by acquisition.

Ultimately, we know that by recruiting and retaining the best people and providing our clients with the best advice and service, we are well positioned to outperform over the long-term. Our commitment to these ideal is unwavering.

Thank you again for dialing in and with that, let's move to the Q&A portion of the conference call. I am happy to answer all of your questions.

Question-and-Answer Session

Operator

[Operator instructions] Our next question is from the line of Glenn Schorr with Evercore ISI. Please go ahead.

Glenn Schorr

Hi thanks very much.

Martin Chavez

Good morning, Glenn.

Glenn Schorr

Good morning. So, I definitely heard all the commentary on FICC and I think commodities is one of the things that stands out that's makes you different than the others, but maybe we could talk about the mix of clients and how much that adds to may be the differentiated performance that we're seeing meaning you see more volatility dependent right.

We've talked about in the past and when VaR's low your revenue struggle more than others. Is there anything that Goldman can do to broaden the mix of both clients and products to be less volatility dependent.

In the past, you had a relationship with Sumitomo that brought a bigger lending mix. I am just thinking out loud.

Martin Chavez

Sure Glenn. Obviously, that's a question on our mind as well as yours and so to step back for a moment, while there are nuances and everyone's franchise is a bit different as we all know, our franchise emphasizes providing liquidity to active asset managers.

So, it really isn’t just a question of low volatility. It's more a sequence of low volatility, less dispersion, less client activity, reduced opportunity set and lower revenues. Also, as you mentioned and I mentioned in the prepared remarks, we have a leading commodities business, which has a greater weight in our franchise than in other franchises.

And it was a challenging backdrop for commodities really challenging on all fronts and in addition, while it was a potentially better business environment for mortgages year-on-year, we have a smaller way of mortgages in our franchise. So those are some effects that are likely there.

To get to the second part of your question on actions that one can take, I can tell you that everyone in our FICC business is intensely focused on this topic and at a granular, molecular level working on it as are all of us in the leadership team.

So much of it is blocking and tackling. So, in no particular order, we're looking to see where potentially there are gaps in our client coverage and onboard new clients and serve them. Also, the ongoing question in every business generally is how do we do better with the clients who are already clients of the firm.

How can we cover them better? How can we have a greater impact with them? How can we provide them new solutions to their challenges and that is really an iterative process of communicating with the clients?

Our business starts and ends with them and those communicating with them, coming up with new products, technologies, tools, analytics, workflows and iterating that we have on offering that is what they're looking for and that's something that we're going to continue doing and we're totally committed to it.

Glenn Schorr

Maybe the related follow-up is more cyclical than that structural peace and just I guess I would scratch my head at times and say why is volatility so low like theoretically we've been waiting for this inflection 0.4. The U.S. to be off QE to start raising rates, which is different than what's going on in Europe and Asia.

You've had some currency movements, some commodity. You would have through this would've been a better valuable backdrop and people would've wanted you liquidity, but it's not happening.

Martin Chavez

I am sorry, I interrupted.

Glenn Schorr

No, I don't know. Are we hooked on idiosyncratic events and actually these asset class moves aren't good enough?

Martin Chavez

What I would say there Glenn is really on predicting when anything will be different than it is just looking back historically one year ago exactly at this time, I don't think any one of us would've predicted the strong client activity, market environment of the second half of 2016.

It arrived and we had the capacity to serve our clients when they became more active on the back of any number of events happening globally. As for the environment generally, one can think of a number of possible drivers that would -- that would change the environment, some things that would potentially be supportive.

The greater client activity would be of course economic growth, confidence, pro-growth policies, but ultimately our business is driven by the clients and their activities.

Glenn Schorr

Okay. I appreciate it. Thank you.

Martin Chavez

Thank you, Glenn.

Operator

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

Martin Chavez

Good morning, Michael.

Michael Carrier

Good morning. Just one more question on the FICC side. You mentioned in terms of looking at the business and maybe some of the client gaps the market share. I guess when we look at the first half of '17 its weak and maybe commodities is a bigger part of that.

But I think even in '16 when we look at the global competitors, it seems like the FICC business has been a little bit more challenged. So, I am just trying to figure out how far along to gain that process is the management team or is the FICC franchise in terms of reassessing whether it's a client, the product mix to try to diversify and broaden some of the growth opportunities?

Martin Chavez

Well it's a good question and so let's go into some other effects that may be going on here and also caveated by saying that we don't have transparency into our competitor's FICC businesses, but I'll note that historically we'd had strength in derivatives and this was a weak quarter like the first quarter for derivatives.

Also, it's likely that some of our competitors have bigger corporate footprints than we do as well as bigger financing footprints than we do and so while four of our business in FICC has been as I mentioned providing liquidity to active asset managers, it isn't a matter of just focusing on active asset managers and having a leading active manager franchise.

It's also a question of how we can deepen our impact with the clients and have a leading cash offering as well. So, it isn't one or the other. It's a question of doing both. Similarly talking about asset managers, we can have a great asset manager franchise and a great corporate franchise and working on both.

And so, this is something that all of us are evaluating and making changes and working on and we're committed to it. We know we need to do better.

Michael Carrier

Okay. And then just a follow-up I guess on CCAR and just capital priorities, given the combination of some of the maybe challenges on the trading side, but then also just evaluation of the stock, is there anything changed in terms of how much you guys are focused on capital return verses reinvesting in the business, M&A activity and if there is areas I know you guys been active on the asset management side, but anything else on that front?

Martin Chavez

Well just a few thoughts on CCAR. We learned a lot going through the process for a few years now and without question the process makes the industry safer and sounder. This year, the Federal Reserve's analysis showed that the 34 banks could withstand $0.5 trillion in stress losses and continue lending to the clients.

It's a robust process and it's evolving every year and ultimately regulators have the authority for capital. Of course, we have our view and detailed analytics of what's the right amount of capital to hold.

At various times in the past, as you know, we've resubmitted on CCAR, which is another way of saying that we believed that we had more excess capital than we could return or deploy. This year we did not resubmit and we deem it important to operate from a position of strength.

I have therefore excess capital and also to have excess capital to deploy to the clients and we're ready and looking forward to increase opportunity and increase client activity and therefore more opportunities to deploy capital.

Michael Carrier

Okay. Thanks a lot.

Operator

Our next question is from line of Guy Moszkowski with Autonomous Research. Please go ahead.

Guy Moszkowski

Good morning, Marty.

Martin Chavez

Good morning, Guy.

Guy Moszkowski

So, you talked a lot about customer sets and just very, very low levels of volatility and activity and I think a lot of that is manifest to the market. So, we get that. That said, you've said now twice in last quarter's call and this one that you could've navigated the markets better and is that only with respect to commodities? Is that more broadly and can you just give us a little bit more color on what you mean by that?

Martin Chavez

Sure, so looking at our FICC businesses as we discussed, year-on-year they all declined except for mortgages and sequentially they all declined and while there are nuances, the primary driver across most of the businesses and I'll get to commodities in a moment, the primary driver for the decline sequentially or year-on-year was lower client activity with all the drivers that we discussed, lower volatility, less dispersion, less opportunity set.

Commodities as a story of challenges on all fronts and there it was lower client activity and also a difficult market-making environment as you know in market-making if I could use for a moment a store analogy though is more complex than the typical store, our clients we need to have in our store that the clients are seeking and we need to have a capacity to create the products that the clients are seeking and sometimes clients are also selling us products they go into the store, which is maybe different from a typical store.

And all of this is happening in a dynamic market environment where the value of all the products in the store is moving up and down and so managing that central problem of risk management in a market-making business requires choices and art and science and it's an uncertain process and you can make the choices and have less than good outcomes.

And so that's what I mean when I say it's challenging market environment and also, we didn't navigate the markets and making those choices as well as we -- as well as we want to and as well as we typically have.

Guy Moszkowski

Okay. That's helpful. Thank you. And then turning the page to equities, which we haven't really talked about much, but where you actually had a pretty meaningful improvement relative to both of the reference quarters and looking in particular at the customer execution.

Are you starting to see some of the benefits of the investments that you've made in quant-oriented products? Did you just have a very successful period in terms of equity derivatives despite the fact that VaR wasn't greatly.

Actually, you said, cash products and it doesn’t sound like it was that, maybe you can just give us a little bit more color for how you saw such a significant increase in execution results?

Martin Chavez

Guy, I would be very happy to go into some significant detail on our equities business. As you mentioned it was an environment of higher equity prices and low volatility and then you asked the questions why is this -- how is this different and I would note several things.

First, our volume held up rather well and you can see that in the commission line, which we break out. Then looking at the equities client execution line and you referenced this, we had a better cash results globally and beyond the U.S. we had better cash and derivatives results.

And we noticed our market share going up not just with our active manager client, but also the passive managers as for providing capital and equities client execution we observed increased demand around a variety of events. The European elections also as we noticed last year around the Brexit referendum in addition as it relates to equities client execution we observed a normalization in the markets in Asia.

And to get to another part of your question we are observing the positive results of investing over multiple quarters in both execution and in and in capital commitment and then in addition I would note corporate activity remained healthy and is typically not correlated with the activity of the active manager clients.

And so, I’m referencing all of these because they're all interesting and useful observations and notions that we can apply in our other businesses. For example, in the fixed business we've already begun applying some of these and for instance U.S. corporate credit and now our extending it to Europe and into our other businesses.

Guy Moszkowski

So perfect. And just one more from me which is sort of part question part observation on the CCAR results. If the question is would you ever consider changing your policy to tell us what you were approved for like most of your peers do -- all your peers do. I think analyst investors are grown up enough to understand it's not a commitment that it's just an approval. But the observation part of it is I just don't think you’re doing yourself any favors by not telling us?

Martin Chavez

Well I appreciate you’re sharing that observation Guy and I’m not going to make a prediction about what we will or won't do in the future. Obviously, we do think about this a lot and we have observed that the other banks who went through the CCAR process disclosed their authorizations.

We just see it as such dynamic process and as you said it's not a commitment and we know you understand that nevertheless because it's an authorization and were constantly reevaluating it we haven't disclosed it and that's where we are.

Guy Moszkowski

Okay. Fair enough. Thanks very much.

Operator

Your next question is from the line of Jeff Hart with Sandler O'Neill. Please go ahead.

Jeff Hart

Hey, good morning. My question is more on a macro level as we're looking at potential LCR and SLR easing. I'm kind of sitting back trying to think how much LCR/SRL easing could potentially increase the financing available to clients and therefore kind of boost trading volumes overall market activity.

But I guess I'm kind of looking back at 2Q 2014 we got the final SLR rule and we saw your repo book really kind of decline that quarter. How much would easing there help overall trading activities – kind of attracting trading activities as opposed to just helping Goldman Sachs I mean give a feel for how big an impact that had in your trading businesses back in 2Q 2014?

Martin Chavez

Oh sure, it's a great question. I'll just step back for a moment to observe the executive order and then the treasury report that followed it which I know all of us I have reviewed. There is order of 100 recommendations in that report as you know.

And about two-thirds of them roughly our activities that the regulators could undertake that don't require legislative authorization and the report did get a bit more specific on the ratios that you mentioned are particularly SLR and there's certainly been a lot of commentary and research out of the market about what changes to the SLR might create in terms of capacity.

And there's many views on this as you know SLR was the most binding metrics for us this year it was the first time that it was incorporated into the CCAR process although as to how the CCAR process will evolve with stress capital buffers and other proposals, but it's really not knowable.

We also note and you know that various regulators have expressed different views on recalibration for instance Governor Powell was broadly in favor and the Chairman of the FDIC Mr. Gruenberg not so.

And so, I wouldn't want to speculate too much beyond saying that if the treasury report's recommendations were to be adopted by the regulators and as I said that's not knowable right now, but if it were potentially a recalibration such as that might change the way that we think about our prime brokerage business and the matchbook business.

But as for how that will show up in client activity and revenues there's many inputs to client activity and this is just one.

Jeff Hart

If I mean – has the availability of financing the kind of active trading accounts been a meaningful deterioration I guess maybe problem over the last couple of years.

Martin Chavez

I wouldn't say it's a problem it's just we're continuously evolving and responding to the regulatory environment capital plan it's a planning processes it's complex, it's nonlinear it's changing and not sure that that any of this has really much of an affect on whether there are alpha opportunities for the active managers.

Jeff Hart

Okay thank you.

Operator

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

Betsy Graseck

Hey good morning.

Martin Chavez

Good morning Betsy.

Betsy Graseck

Two questions just one you mentioned in our prepared remarks that some of what you think you'll be doing or focusing on as an organization is just play no blocking and tackling could you just give a sense as to what you mean by that I have my own views but I wanted to understand what you meant by that?

Martin Chavez

Sure, so blocking and tackling is actually a very broad topic and a lot of this is just what any business would do. It's our people across the firm at all levels of seniority meeting with clients.

There is no substitute for going to visit clients and talking with them and understanding their objectives, their benchmarks, their challenges things that are working for them, things that are not, understanding how they see the value that we’re adding to them whether it's in liquidity provision or other services.

Understanding ways in which we can have a better engagement with them and for instance a topic that we've been working on for some time now ways of extending and sharing our analytics and data with them as a way of bringing them the relationship strengthening the relationship and leading potentially to more activities.

So, there is certainly just this aspect of that’s constantly changing because the client needs and requirements are changing for risk management products and services and the format, the package, the way in which they want those services delivered and the only way to know about that is to work with the clients at various levels front, middle and back across the client organization, engage with them and iterate.

We've done this in other businesses as I just mentioned we've seen the fruits of doing this and for instance are equities business which is led to new offerings over the last few years but it's really something that applies very broadly across our businesses.

And investment banking a few years ago we identified an opportunity to do better with our clients and to cover more clients and debt capital markets. And you’ve seen the results of that multiyear effort in our league table rankings and in our revenues in investment management, the opportunity to provide holistic solutions to clients for instance CIO outsourcing on and to deliver that organically as well as through acquisitions.

And so that's an example and really, we see all of these approaches and techniques as applying very broadly across all our businesses and there is a huge emphasis in doing that in our FICC business as well.

Betsy Graseck

Got it, okay. And then just separately switching gears to Marcus, there's been some contrary I think Lloyd and others have talked about, the take a rate that you've had.

Could you give us a sense of progression from here, are you looking for the same level of growth that you've been able to generate and how much over the course of the next couple of years do you anticipate taking your risk capital and applying it to utilizing in Marcus?

Martin Chavez

So, as you know with Marcus, we saw an opportunity not the very long ago given our market position, our strength in technology and analytics and that fact that we didn't have bricks-and-mortar branches or legacy systems or credit card and just looking at all of the activity in this burgeoning world of digital consumer finance, we saw an opportunity.

And we put together deliberate methodical organic plan. Lloyd mentioned some of our progress according to that plan where we crossed the billion-dollar threshold in loan balances and this customer centric plan is progressing and we're executing according to plan. We don't have loan balance targets and we're excited about this business and believe that it can generate high-teen ROEs.

Just stepping back, like to take a minute to put Marcus in a broader context of all the ways that we're seeking and delivering growth opportunities for the firm.

First one is the market, another one is expanding the franchise, another would be improving our relative positioning and then also new products and opportunities even in our mature competitive market such as banking, institutional client services, investment management there is opportunities to close market share gaps, improve the client mix, do better with the clients and we've taken purposeful op actions to make that happen.

There is in the area of the consumer a number of new opportunities that we're evaluating including Marcus which is the first example and an opportunity to leverage our strong brand into areas beyond our traditional franchise and Marcus is one such greenfield opportunity where we don't need a leading market share for it to be a significant opportunity for us.

Betsy Graseck

And then last, does it help with CCAR at all?

Martin Chavez

I’m sorry, could you repeat that, I didn’t hear that.

Betsy Graseck

The markets revenue stream, the NII associated with it, does that help at all with CCAR there an opportunity to improve the optionality in the capital structure by having this type of revenue stream come through?

Martin Chavez

I think it's a little too early to answer you on that when Betsy. Marcus really isn't - it's not a material NII story at this point its really much more return on attributed equity story and as you know CCAR is included constantly evolving process.

Betsy Graseck

Sure. Okay, thanks.

Operator

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

Brennan Hawken

Good morning, Marty. Thanks for taking the question. I got a follow-up on FICC. So, you spoke to the market making and issues of setting risk book but just wanted to dig in a little because sequentially bar is down for you guys but yet stable at many of your money center competitors which I would think should normalize for market volatility.

So, could you square those two factors going on? Did something happen where early on the market making difficulties you ran into were early on in the quarter and then you guys cut back a bit on the balance sheet that's what lead to the bar decline versus peers sequentially? How do that all shake outer or any increase color will be helpful?

Martin Chavez

Everyone's approach to bar in the way in which people incorporate bar into the businesses is different. We don't have bar targets and bar is an output of client's activity, client demand for capital as we discussed and as you noted it declined from $64 million to $51 million sequentially, so call it 20% and looking across the product areas, really, it's lower volatility as the main driver in currencies, there's a bit of a positional driver in addition to the ball driver.

And then also there is a diversification effect so there was increased correlation and just the change in the bar as its measured in the different product areas but led to a change in diversification effect so that was a small contribution to bar. But really, it's not a matter of cutting it back. It's just a matter of - there was less client demand for the bar capacity.

Brennan Hawken

Okay. And then another follow-up here on the commodity comments that you made earlier. So, a few years ago, Goldman disclosed to breakdown of your FICC business with commodities being roughly 8% of ICS revenues.

It seems as though your commentary suggests that that has increased in recent years. Can you give us a sense about how large you think on average that's trended over the last couple of years versus this several years ago disclosure at this point?

Martin Chavez

So, I would just observe that out of the 73 quarters that we've been a public company, it was the worst quarter for the commodities business and we don't break out further - the contribution of the individual product lines.

There is a lot of reasons for that but really, we just think of it as a business that serves the clients holistically across a number of different products. And that's where I'll leave it.

Brennan Hawken

Okay. Is it possible just to clarify a bit here. Was it - given it's a worst commodities quarter on record, does that mean that it might have actually even been in - there could've been a negative revenue figure or was it positive or is that something you can't disclose?

Martin Chavez

I'll just say we don't disclose the product break-out.

Brennan Hawken

Got it. Worth a shot. Thanks Marty.

Martin Chavez

Thanks.

Operator

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

Jim Mitchell

Hey, good morning. Maybe a question on the derivatives bigger picture. You guys always had superior risk management that enables you to be kind of top market share in derivatives.

But I guess the question is then, how much do you think or are concerned about maybe structural headwinds on the demand side when you have greater transparency in the markets you have pressures on fees and flows on active managers and passives and even exchanges are trying to grab market share from OTC markets.

At what point I guess do you start to rethink that business and your advantage in the business or was it something, hey, we just have to maintain our top market share and hopefully it comes back. Just, how are you thinking about the response to any - I guess continue pressure in that business relative to the peer group?

Martin Chavez

Sure. It’s a great question. So just to one micro point that you made on exchange versus OTC, I'll note that that it's often the experience that they really - if they might seem like there and our position to one another.

But often there's actually a virtuous cycle where the availability on exchange liquidity actually makes it easier for market makers to make markets and OTC products, therefore hedging more on exchanges so it's a virtuous cycles. So, I wouldn't necessarily see those in our position.

As for derivatives versus cash, again it wouldn't see it as one or the other why not why not both and of course we're going to continue investing in our historical strength in derivatives and stay with our clients over the long term not just in the quarters where there are extremely active.

But I’ll just note that as or product formatter or package right there, there's so many different formats and they are constantly evolving right.

So for a particular kind of risk, you could have futures, derivatives, cash, systematic trading strategies, ETFs, and it just goes on and on, and really as opposed to attempting to predict which product format is going to be appealing to the client, I think that would be really brittle to have a prediction and move everything in that direction and really the way we're seeing it, the way we see generally everything is preparing the firm to respond to a variety of different market states and a variety of different client needs.

And so, if the clients are in some period of time and it could be - secular could be cyclical doesn't it doesn't matter who knows if the clients are looking for cash solutions, then building strength in cash solutions is part of what will do.

We have experienced and I'll just note, the equities business is one example of defining commissions and commissions are at a small fraction in the equities business of where they were, say 15 years ago and that has not been an optical to constantly evolving the business and finding new ways to serve the clients and I expect that kind of learning and things we've learned and observed in our U.S. corporate credit business to be a valuable observations that we can extend to all of our businesses.

Jim Mitchell

That makes sense. Just maybe one quick follow on that. Just, do you think there is a correlation in say hedge fund clients' willingness to take on leverage in the derivatives markets.

Is it correlated you think with sort of flows like their desire to stay more liquid and therefore don't want to take on say more illiquid assets like derivatives and that's something we should be watching to see an inflection there. How do you think about what is driving their decision-making process?

Martin Chavez

There you know would be tough to speculate on their thought process. Of course, we talk to them and all the time and what they're telling us is that this whole backdrop of lower volatility, less dispersion, leads to less conviction and a lower opportunity set for them and for us.

Jim Mitchell

Okay, great. Fair enough, thanks.

Martin Chavez

Thanks Jim.

Operator

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

Steven Chubak

Hey Marty. So, I had a follow-up question on the line discussion on derivatives. There was a report that was published a few years ago by the Financial Crisis Inquiry Commission, which show that derivatives actually contributed more than 50% of your fee revenue.

And giving the impact that weaker derivatives had on results this quarter and recognizing as you notice, there are lot of different derivative product formats we need to think through. How is that mix evolved in recent years and how should we expect that to project longer-term?

Martin Chavez

So, great question Steven, I'll just note that we don't really - while of course we have all kinds of analytics, we don't really break out the business in that particular way.

We have noted that that ratio between cash and derivatives, for example in the rates business just to give one example, where there is for instance stock data repositories, and there is other data sources.

It seems there is more activity really across the industry in the product format of T-bills in future but of course swaps - old swap continue to be a hugely important part of that business.

Again, I'll just go back to what I mentioned which is something we believe profoundly which is that we go where the clients lead us and of course it's iterative, we have ideas for new products and solutions and we work on that with the clients and we see if it fits their needs and we evolve from there and we plan for a variety of different outcomes.

So is there a trajectory on more derivatives versus cash in the future or less, that's really not how we think about it. It's much more a matter of being prepared to offer the clients both and it's become increasingly much more dynamic and just that kid of dichotomy of cash or derivatives.

There's product formats that are being created really all the time and having the capability and capacity to operate across products and across different kinds of product format, it's caught our franchise.

Steven Chubak

Got it. And just one follow-up for me on the discussion on the treasury white paper and the SLR in particular. We and many of our clients are going to the exercise of trying to assess the cumulative benefits that could accrete to you as well as many your peers.

And you noted that the SLR and CCAR appears to be your binding constraint today. But will the constraint that appears to be nearly as binding is the 4% Tier 1 leverage in CCAR?

And didn't know if you had any thoughts just to whether you anticipate that in a similar vein or fashion that CCAR would be applied to that measure as well or how you're thinking about binding this in the event that you get some of those reforms as outlined by the treasury pushed through?

Martin Chavez

Well, it's a great question Steven. I would say that we don't really other than the observation which you can see on the Fed's website that SLR was binding this year, we don't really - I don't think it would be useful to call out a particular rule.

There is - as we look at the way, the rules written, they are having a powerful effect on systemic safety and soundness and even before the election and the executive order and the treasury report, regulators were already beginning to step back and look at the totality of the rules and see all the ways that they interact.

Just as one example, Governor Tarullo gave a very thoughtful speech on stress capital buffer concept as a possible evolution of CCAR.

We don't know when or if that concept will appear in CCAR but interestingly that approach links capital returns, balance sheet, risk-weighted assets, bought and stressed ratios really in a manner that is very aligned with how we think about capital planning and all of these metrics and feed into one another and there's an interplay.

So, I don't think it would be useful to speculate on any one metric other than to say, we do, we build analytics, models, processes and we set ourselves up so that we can respond to the client in a variety of different regulatory and market scenarios.

Steven Chubak

Thanks Marty.

Operator

Our next question comes from the line of Gerard Cassidy with RBC Capital. Please go ahead.

Gerard Cassidy

Thank you. Good morning, Marty. I don't know if I heard you correctly and I apologize ahead of time but when you're talking about the FICC business, obviously customer behavior and markets the lack of volatility was a contributor to the week number in FICC but I think you also said you weren't as happy about your navigating or your company is navigating in the markets.

If that is - if I heard it correctly, how much of the downturn was due to the customers versus your own trading capabilities and how does that compared to the first quarter when you compare the two?

Martin Chavez

I think to go back to that store analogy, there is - well it would be - maybe a wonderful utopian thing to be able to operate the two and say one is client activity and one is when it navigating the markets.

There really interwoven and so in making prices to clients, they want to buy so we sell, they want to sell so we buy. There's choices there and then in the strategies that we employ to manage the resulting basis risk, this strategy is there and we step back in and at the end observe the results.

And it was a comment that I really wanted to make very particularly about the commodities business. As for the rest of the FICC businesses, it really was a story of lower client activity very good.

Gerard Cassidy

Very good and then coming back to the investment banking pipelines, can you give us more color geographically or industry strategic versus financial. What are you guys seeing in that pipeline?

Martin Chavez

Sure, so it – I look at the backlog and really, it's driven primarily by underwriting but looking at banking broadly I would say the CEOs are confident, the conversations are happening all the time and strategic M&A in the U.S. those discussions are occurring especially in technology and consumer retail in natural resources in Europe.

I would say it's hard to predict given the Brexit uncertainty there is healthy activity and we certainly see opportunities in Europe for debt underwriting.

In Asia, we're still seeing the trend of Chinese buying and international assets. And we remain optimistic over the long-term and as for the debt markets again no predictions here other than to note what we all know which is that trends in rates, and spread and volatility in M&A activity all drive demand for issuance.

And even though rates have moved up overall financing tasks are still quite low by historical standard.

Gerard Cassidy

Great. And then just finally, can you guys give us any additional color on the treasury's proposal for retrofitting the Volcker rule just how you guys are seeing as it involves?

Martin Chavez

Again, I would say there is the treasury's proposal and there is discussion about how Volcker might evolve as it relates both to market making as well as to the Volcker covered funds. I wouldn't make any specific comment on how Volcker might evolve other than to observe and with the regulators, multiple regulators have talked about this publicly.

They're taking opportunities to step back and potentially recalibrate what I would say is that as and when this recalibration occurs we'd expect the regulations to continue to be thoughtful, to protect the system and at the same time to support growth and well-functioning market.

Gerard Cassidy

Really appreciate it. Thank you, Martin.

Martin Chavez

Thanks.

Operator

Your next question is from the line of Al Alevizakos with HSBC. Please go ahead.

Al Alevizakos

Hi Martin, thank you for taking my questions. My question is basically we talked a lot about equities and obviously the performance is very strong particularly after I think the relative underperformance in Q1.

And I wanted to actually touch on the equity capital markets on ECM I was surprised because the figure was actually weaker than I was expecting. And it was coming off a weakest Q2, 2016.

And I also believe that the biologic numbers were pointing up overall materially for the quarter. So, would you mind telling me if there was something special where all you think like it was kind of one-off that's going to be reversed in Q3?

Martin Chavez

That's a great question, so as you noted year-to-date our volumes are strong and outperforming and of course the quarter is important and useful and standard are construct. And at the same time – it can also be relatively arbitrary boundary. But working within that boundary sequentially they were lower follow-ons.

And year-over-year lower converts and as for the drivers of the revenue results as they think from the volume results it's something that is a very complicated output. There is audio break where one can get conflicted out sometimes in smaller deals.

There is actually fewer underwriters and as you know everyone is part of the league table, but at least your underwriters, there's fewer things to share among and so there is a lot of effect going on there as for what the actual drivers are. As we always do we'll look into it and respond.

Al Alevizakos

Great. And if I can turn your attention into the I&L division. You've already spoken about the NII strength. And you said that the figure is more around US$400 million. I'm just trying to get a feeling on the recurring part that relates to your increased lending through corporate and private banking versus the standard kind of one-off interest that's coming from your equity investments.

Could you kind of give us an indication whether you start seeing more and more recurring NII shift in the division?

Martin Chavez

Well, looking at I&L portfolio, right now it stands at just over $106 billion and that's almost $4 billion increase sequentially and 79% of that is lending. On that NII figure that we quoted more than $400 million that is recurring.

Al Alevizakos

Okay. Great. Thank you very much.

Martin Chavez

Welcome.

Operator

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

Brian Kleinhanzl

Thanks Marty. So, couple of quick questions here. On the deposit front, I know you've been growing and kind of consumer I guess we'll call those consumer deposits and I know that everyone has been growing markets that much.

So, what other businesses are being funded by those deposits?

Martin Chavez

I am sorry, I didn't hear the last part of the question. Could you say that again Brian please?

Brian Kleinhanzl

Yeah, which other businesses are utilizing that deposit funding? Are you supporting I&L?

Martin Chavez

All right. Sorry, yes. So, well our private wealth management business is an example of one of those businesses as of the first quarter is about $29 billion of loans and commitments to our private wealth management clients and that's up about $1 billion sequentially.

Brian Kleinhanzl

Okay. Thanks. And have you seen any specific impact from MiFID II on your overall businesses both in equity and FICC that play a role in the results this quarter?

Martin Chavez

I would say it's significant certainly in terms of the effort across our businesses and really as you know MiFID II is an extremely broad undertaking, arguably broader than for instance the U.S. regulatory changes since the crisis.

I would just call out a couple of major areas of MiFID II. So, on execution services as that evolves we're staying close to the clients and then as for research, it's crucial we believe to continue to provide differentiated strong content into the scale player with differentiated content that the client's value.

Potentially there is some mind share impact because this is a big list across the industry with a singular go live date in early January of next year, but as for whether there is a long-term impact, it's too early to assess.

Brian Kleinhanzl

Okay. Thanks.

Operator

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

Martin Chavez

Well first I would like to thank all of you for calling in. I've met many of you and I look forward to getting to meet all of you in person. If you have any additional questions please don't hesitate to call Dane and I wish you all a great summer. Thank you.

Operator

Ladies and gentlemen, this does conclude the Goldman Sachs second quarter 2017 earnings conference call. Thank you for your participation. You may now disconnect.

Comments (0)