Seeking Alpha α
Transcripts | **Financial**

Fifth Third Bancorp's (FITB) CEO Greg Carmichael on Q3 2019 Results - Earnings Call Transcript

Oct. 22, 2019 6:36 PM ET | 1 Like
by: SA Transcripts

Q3: 10-22-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $0.75 beats by $0.02 | Revenue of $1.99B (23.35% Y/Y) beats by $45.7M

Earning Call Audio

Subscribers Only

0:00:00 -1:23:29

Fifth Third Bancorp (NASDAQ:FITB) Q3 2019 Earnings Conference Call October 22, 2019 9:00 AM ET

Company Participants

Chris Doll – Director of Investors Relations

Greg Carmichael – President and Chief Executive Officer

Tayfun Tuzun – Chief Financial Officer

Lars Anderson – Chief Operating Officer

Jamie Leonard – Executive Vice President and Treasurer

Frank Forrest – Chief Risk Officer

Conference Call Participants

Matt O'Connor – Deutsche Bank

John Pancari – Evercore

Ken Usdin – Jefferies

Gerard Cassidy – RBC

Peter Winter – Wedbush Securities

Brian Foran – Autonomous

Erika Najarian – Bank of America

Saul Martinez – UBS

Mike Mayo – Wells Fargo Security

Marty Mosby – Vining Sparks

Vivek Juneja – JP Morgan

Christopher Marinac – Janney Montgomery Scott

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Fifth Third Bancorp's Third Quarter 2019 Earnings Call. At this time, all participants' lines are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's call is being recorded. [Operator Instructions]

I would now like to hand a conference over to your first speaker today, Chris Doll. Please go ahead, sir.

Chris Doll

Thank you, Prince. Good morning, and thank you for joining us today, we'll be discussing our financial results for the third quarter of 2019. Please review the cautionary statements on materials, which can be found in our earnings release and presentation. These materials contain reconciliations to non-GAAP measures along with information pertaining to the use of non-GAAP measures as well as forward-looking statements about Fifth Third's performance. We undertake no obligation to and would not expect to update any such forward-looking statements after the date of this call.

This morning, I'm joined by our President and CEO, Greg Carmichael; CFO, Tayfun Tuzun; Chief Operating Officer, Lars Anderson; Chief Risk Officer, Frank Forrest; and Treasurer, Jamie Leonard. Following prepared remarks by Greg and Tayfun, we will open the call up for questions.

Let me turn the call over now to Greg for his comments.

Greg Carmichael

Thanks, Chris. And thank all of you for joining us this morning. Earlier today, we reported third quarter 2019 net income available to common shareholders of $530 million or $0.71 per share. Our reported EPS include a negative $0.04 impact from the items shown on Page 2 of our release, mostly from merger-related expenses associated with MB Financial.

Excluding these items, adjusted third quarter earnings were $0.75 per share. Our financial results were very strong and reflect our ongoing discipline throughout the bank as well as the strength of our diversified revenue streams. We generated strong fee revenue, including a record in capital markets while tightly managing our expenses. Our revenue and expense results exceeded our July expectations.

During the quarter, we also returned 96% of our earnings to shareholders in the form of common dividends and share repurchases. Adjusted pre-provision net revenue increased 28% from a year ago to quarter. The strong performance reflects our ability to generate strong core revenue growth, diligently manage our expenses and deliver on our financial commitments from the MB Financial acquisition.

We also generated strong core deposit growth compared to the prior quarter while proactively lowering interest-bearing deposit cost. All of our key return and profitability metrics improved significantly in the third quarter as we achieved our year-end financial targets by generating an ROTCE excluding AOCI of 16.5%, an ROA of 1.35% and an efficiency ratio below 57% on an adjusted basis. Our ROTCE has increased 280 basis points. Our ROA has increased 7 basis points. And our efficiency ratio has decreased 260 basis points from the year-ago quarter.

End-of-period loans were flat sequentially. Our commercial loan production continued to be strong during the quarter but was muted by elevated payoffs. Consistent with our prior guidance, we generated average consumer loan growth of 2% sequentially. We remain focused on maximizing our returns through the full cycle rather than generating a lower-quality loan growth. Credit quality once again remained relatively benign during the quarter. Non-performing assets and the NPA ratio both declined from the prior quarter, and many of our credit metrics remain at or near historical low levels.

Before I turn it over to Tayfun to discuss our financial results and fourth quarter outlook, I'll review our four key strategic priorities to improve our long-term performance. First, we continue to leverage technology such as our data analytics capabilities to accelerate our digital transformation. Our investments are focused in areas that reduce the friction inherent in traditional banking channels while also investing in areas that drive operational efficiencies. We have made considerable investments over the past several years to modernize, simplify and rationalize our infrastructure.

In addition, we're investing in advanced fraud and cybersecurity technologies to detect and respond to threats quickly. In total, our annual technology spend exceeds $650 million. While we will continue to invest in technology next year and beyond, we expect our investments will lead to improved efficiencies throughout the bank.

Second, we continue to invest to drive future organic growth in some areas of the bank. The ultimate goal of our investments is to improve both the employee and customer experience in order to support sustainable, profitable growth. We believe it is critical to provide our employees with the right tools to maximize productivity, particularly those who directly interact with our clients.

To that end, we recently announced an increase in minimum wage for our employees to $18 an hour effective at the end of this month, which will primarily impact those located in branches in our operations center. We fully expect that this increase will lead to lower employee turnover, with better customer experience and, as a result, improved revenue growth. We have also added talent and capabilities to our Texas and California geographies. We remain pleased with our ability to successfully generate strong relationship growth while maintaining a credit standard consistent with our in-footprint, middle-market banking business.

In addition, we've already seen positive financial outcomes from our renewable energy M&A advisory team, which complements our investment banking capabilities to deliver strategic client solutions throughout our national commercial franchise.

Third, we continue to expand our presence in select key geographies, including Chicago. As I have mentioned previously, our strategy is to generate a higher market share in large and high-growth markets. Our employees remain energized about the combined potential for Chicago. Our overall employee attrition continues to track our original deal expectations. Most importantly, we have not experienced any material client attrition. We remain very pleased with the middle market loan production in our Chicago region, which was by far, the strongest region during the quarter.

Although we are not finished working to ensure a sustainable success, we remain pleased with the progress we have made so far. We are confident in our ability to deliver the financial synergies from the MB Financial acquisition, as previously communicated. We continue to expect to realize the $255 million in annual expense synergies by the end of the first quarter of 2020 and have already completed many of the key expense actions. We also continue to expect revenue synergies to generate approximately $60 million to $75 million in annual pretax income by 2022.

Our commercial teams have done a great job in laying a foundation to leverage our capabilities and strength across our entire franchise. We already see success generating incremental revenue opportunities. For instance, we are successfully leveraging our enhancements and capabilities to provide value-add client solutions to all our middle-market and corporate banking clients. We continue to believe that Fifth Third Chicago is in a position of strength that allows us to generate stronger deposit, household and revenue growth moving forward.

With the MB acquisition significantly improving our position in Chicago MSA, we are continuing to invest in our Southeast markets. With their deposit growth trends, I expect the population growth and greater market vitality.

Lastly, we are focused on maintaining our disciplined approach throughout the company. While we continue to expect generally stable credit quality, we are cognizant of the evolving economic and interest rate environment. From a balance sheet perspective, we have successfully generated strong deposit growth while maintaining pricing discipline. We expect to continue our strong deposit growth at minimum going forward. Our average loan-to-core deposit ratio of 91% is the lowest in over 15 years, reflecting our ability to generate strong core deposit growth and an unwillingness to stretch for loan growth. We expect that this ratio will remain in the low 90s for the foreseeable future.

Our balance sheet management philosophy of focusing on improved performance to the full economic cycle positions us well for the future. Given our capital management priorities, our focus on returning capital through dividends and repurchases, in addition to the organic growth strategies I mentioned, bank acquisitions are not a priority. We have continued to demonstrate our discipline in managing our expenses diligently and investing in areas of strategic importance. Though expense declined $3 million sequentially, excluding merger-related items, we generated year-over-year positive operating leverage on an adjusted basis for this quarter. Tayfun will share about more about expense expectations for the fourth quarter.

Our clearly defined strategic priorities and our proactive balance sheet management and our continued discipline throughout the bank position us well into the next year and beyond. We remain cognizant of the dynamic economic and interest rate environment. We continue to focus on through-the-cycle outperformance to create long-term shareholder value. I'm pleased to report that we were again able to deliver strong financial results. I'd like to once again thank all of our employees for their hard work, dedication and for always keeping the customer at this time with everything we do.

With that, I'll turn it over to Tayfun to discuss our third quarter results and our current outlook.

Tayfun Tuzun

Thank you, Greg. Good morning, and thank you for joining us today. Let's move to the financial highlights on to Slide 4 of the earnings presentation. During the quarter, we achieved strong revenue growth with flat expenses and continued benign credit results. With a 3% quarter-over-quarter increase in adjusted total revenue and a slight decline in expenses, our annualized core PPNR as a percent of earning assets of 2.3% in the third quarter of 2019 reached the highest level since 2013.

Reported results for this quarter were negatively impacted by two notable items, a $22 million after-tax impact from MB merger-related charges and an $8 million after-tax negative mark related to the Visa total return swap. Adjusting for those items, pre-provision net revenue increased 7% from the prior quarter, and our efficiency ratio improved 180 basis points to 56.7% as strong firm-wide fee growth more than offset lower net interest income during the quarter.

As Greg mentioned in his opening remarks, our adjusted return metrics were also very strong in the third quarter. We achieved an adjusted ROA of 1.35% and an adjusted return on tangible common equity of 16.5% excluding AOCI despite the market dynamics and stable capital levels during the quarter.

Our adjusted ROTCE is now over 280 basis points higher compared to a year ago and our adjusted ROA is up 7 basis points for the same period as most of our peers have experienced declines in those metrics. At our original CET1 target, which was closer to 9%, our ROTCE excluding AOCI would have been approximately 17.5% in the third quarter. Our performance this quarter also helped us achieve our previously stated year-end return targets one quarter sooner than we anticipated. Clearly, environmental factors especially interest rates will have an impact on these returns going forward. Our third quarter credit performance continue to reflect the generally benign macroeconomic environment with both the NPL and NPA ratios declining quarter-over-quarter.

Moving to Slide 5, total average loans declined less than 1% sequentially. Our focus continues to be on generating high quality loan growth to maximize our returns through the full cycle. In our commercial business, strong origination volumes in C&I were more than offset by elevated payoffs and paydowns. Total commercial line utilization decreased over 1% sequentially, reflecting the broad market uncertainties.

I would also like to point out that the third quarter average loan growth metrics were impacted by higher payoffs and paydowns at the end of June. We also continue to see declining balances in large ticket in direct leasing where we halted new originations in early 2018. Average commercial real estate loans were flat from last quarter. Our CRE balances as a percentage of total risk-based capital remain very low at less than 80%, which keeps our exposure relative to capital near the bottom of our peer group.

We expect that near-term loan growth will continue to reflect the software environment for corporate capital investments. With our expanded capabilities, our new originations continue to remain strong. However, payoffs and paydowns have resulted in muted net loan growth so far this year. Assuming a similar environment in the fourth quarter, we expect average commercial loans to be relatively stable compared to the third quarter.

As always, our focus is on client selection and prudent underwriting as we plan to grow our balance sheet in the best long-term interest of our shareholders. Average total consumer loans grew 2% from last quarter. Overall, consumer loan demand remains at healthy levels within our risk appetite. This quarter, growth was driven by strong auto loan production of $1.8 billion during the quarter.

Auto production strengths were the highest in nearly a decade again with the same strong risk profile that we have targeted for the past number of years. Home equity production was 5% higher this quarter compared to last quarter, but due to pay downs and payoffs, our balances declined. Our credit card growth was in line with the industry.

The residential mortgage portfolio was flat and in line with our balance sheet management preferences in the current rate environment. In the fourth quarter, we expect total average consumer loan balances to increase 1% to 2% sequentially.

Moving on to Slide 6. Reported net interest income was stable compared to the prior quarter. Adjusting for purchase accounting accretion, NII decreased $14 million sequentially or 1%. The purchase accounting adjustment benefited our third quarter NII by $28 million and our net interest margin by 7 basis points.

The adjusted third quarter NIM of 3.25% decreased 7 basis points from the second quarter. Third quarter margin compression was slightly elevated relative to our July expectations due to a larger decline in LIBOR and the shift in the yield curve, as well as elevated cash balances resulting from strong deposit growth.

Our overall interest bearing liability costs continued to be very well maintained down 6 basis points during the quarter. Interest bearing core deposit costs decreased 2 basis points sequentially as we expected. We expect interest bearing core deposit costs in the fourth quarter to decline approximately another 15 to 18 basis points from the third quarter assuming an October fed rate cuts.

During the quarter, the yield on the loan portfolio declined 9 basis points and as we expected, our investment portfolio yield maintained a relatively stable level with the decline of only 4 basis points. Total premium amortization was less than $3 million.

On a core basis, we expect fourth quarter NIM to decline 4 to 5 basis points from the core third quarter NIM of 3.25%. Our guidance incorporates 25 basis points fed rate cut in October and results in a core NIM for the full year 2019 of approximately 3.26%, a 4 basis points increase compared to 2018.

We currently expect our fourth quarter net interest income, excluding PAA to be down approximately 1% sequentially, reflecting the NIM impact and the relatively stable loan growth outlook. As we look ahead to next year, the hedge positions will start contributing meaningfully and at an increasing level to the overall NII based on our current rate outlook.

We expect our core NIM in the first quarter of 2020 to expand a couple of basis points from the fourth quarter of 2019, given the benefit of $4 billion of previously executed forward starting hedges that will begin in December and January. At this time, we expect full year 2020 core NIM to be in the range of approximately 3.2% to 3.25% depending on the size and timing of Federal Reserve actions. We would expect to be at the upper end of the range assuming no fed rate cuts in 2020 and expect to be at the lower end of the range assuming two additional 25 basis points rate cuts in March and September of 2020. We assume that deposit betas will be in the 40s.

In summary, we expect our NIM to widen a few basis points for the full year 2020 relative to the expected Q4 level, if there are no rate cuts and remain fairly stable, if there are two more rate cuts.

Moving on to Slide 7. We had a stronger quarter in fee income than we guided to in July. Adjusted non-interest income increased 11% sequentially led by strong performances in both corporate banking and mortgage banking. As you recall, in July, we guided to a strong second half fee performance and we realized the larger portion of our anticipated growth in the third quarter.

During the last two years, we deliberately channeled our investments in a number of diverse fee generating businesses to maintain our ability to grow total revenues in different environments and our year-to-date non-interest income results demonstrate the increasing benefit of having a platform with a wider scope of product and service capabilities.

Corporate banking fees were up 23% from the prior quarter, significantly exceeding our prior guidance driven by strong growth and debt capital markets, M&A advisory and lease related revenue, all reflecting our diversified and enhanced capabilities to better serve our clients. Our capital markets teams generated record revenues this quarter, partially impacted by clients accessing the debt markets for financing.

Additionally, the renewable energy M&A team that we hired two months ago already closed to transactions during the quarter. For the fourth quarter, we currently expect corporate banking revenues of approximately $150 million or up 15% from the year ago quarter, but down from this record third quarter. Mortgage banking revenue of $95 million increased 51% sequentially. Origination volume of $3.4 billion was up 17% from the prior quarter.

Our gain on sale margin of 232 basis points was up 66 basis points sequentially and 69 basis points from the same quarter last year, driven by expanding primary, secondary spreads, which we anticipate will remain elevated in the fourth quarter given industry wide capacity constraints. Our mortgage platform is stronger today than three years ago based on our investment in our loan origination system. The cyclical nature of this business is providing good revenue support in this environment.

Wealth and asset management revenue increased 2% from the prior quarter due to higher personal asset management revenue. Deposit service charges were flat compared to the prior quarter as higher consumer deposit fees were offset by lower commercial deposit fees. Our strong performance this quarter elevated our second half total fee outlook raising our full year 2019 fee income growth to 17% to 18% from our July guidance of 15% to 16%, once again highlighting the diversification benefit and strength in fee income generation.

Because of the record high numbers in the third quarter, we expect our fourth quarter total non-interest income to decrease approximately 4% from the adjusted third quarter of 2019. This outlook is reflective of seasonality in mortgage banking. We also expect higher wealth management revenues during the quarter.

Moving on to Slide 8. Third quarter reported expenses included merger related items of $28 million, as well as intangible amortization expense of $14 million. Adjusted for these items and prior period items shown in our materials, non-interest expense decreased $3 million from the prior quarter. We remain on track to deliver on the previously provided outlook for MB related expense savings.

We continue to expect to achieve $255 million in savings by the end of the first quarter of 2020 and to capture approximately 80% of the savings on a run rate basis by year end. Additionally, we continue to expect our total after tax merger charges, inclusive of the merger related charges recognized in current and past periods as well as projected future charges to be approximately $250 million after tax. We expect current – we expect fourth quarter expenses to continue drift slightly lower from the adjusted third quarter level, including the impact of the $3 raise in our minimum wage from $15 to $18 effective at the end of this month.

As we look ahead to 2020, we are mindful of the challenging outlook for revenue growth related to slower loan growth and lower interest rates and plan to manage the trends in our core expenses appropriately. While we maintain our focus on investing in our businesses for long-term growth, we will not disregard the near term realities associated with the market environment and the impact on operating leverage. We will share our 2020 expectations with you in January.

Turning to credit results on Slide 9. Third quarter credit results continued to reflect the generally benign economic environment. Our key credit metrics remain at or near historical lows. The third quarter NPA ratio of 47 basis points declined 4 basis points sequentially, while the NPL ratio decreased sequentially to 44 basis points from 48 basis points. Compared to last quarter, commercial net charge offs increased 5 basis points and consumer net charge offs were up 9 basis points, reflecting seasonal factors.

The ALLL ratio increased slightly sequentially to 1.04% of portfolio loans and leases. We currently expect fourth quarter charge offs to generally track the third quarter's performance.

Again, I would like to remind you that the current economic backdrop continues to support a relatively stable credit outlook with potential quarterly fluctuations, given the current low absolute levels of charge offs. We expect to the – with respect to the upcoming CECL adoption, our expected ranges appear to be in line with other banks that have already disclosed their information. In our legacy portfolio, we expect the impact of CECL to result in a 30% to 40% increase in reserves.

Due to differences between the accounting treatment of MB's loans under the acquisition accounting methodology and the treatment under CECL, the increase in CECL reserves for our combined loan portfolio will be in the range of 40% to 55%. This incremental impact is predominantly due to the fact that under the CECL methodology, there is no mechanism that converts the non-PCI discount that we established at the time of acquisition to loan reserves.

Turning to Slide 10. Capital levels remained very strong during the third quarter. Our common equity Tier 1 ratio was 9.6% and our tangible common equity ratio excluding AOCI was 8.21%. Our medium-term CET1 target remains at 9.5%. Our tangible book value per share was $21.6 this quarter, up 17% year-over-year and up 5% from the second quarter.

During the quarter, we completed $350 million in buybacks, which reduced our share count by approximately 13.4 million shares or about 2% of our common shares outstanding compared to the second quarter. We expect to execute the remaining approximately $900 million of repurchases over the remaining three quarters in the CCAR cycle, in addition to raising our dividend by $0.03, which is subject to board approval.

Slide 11 provides a summary of our current outlook. We plan to provide more information regarding our 2020 outlook in January consistent with our normal timing. In summary, I would like to reiterate a few items. Our third quarter results were strong and continue to demonstrate the progress that we've made over the past few years towards achieving our goal of outperformance through the cycle. Our execution on the MB acquisition is on track to meet our targets on both expense and revenue synergies.

As always, we remain intensely focus on successfully executing against our strategic priorities and remain confident in our ability to outperform through various economic cycles.

With that, let me turn it over to Chris to open the call up for Q&A.

Chris Doll

Thanks, Tayfun. Before we start Q&A, as a courtesy to others, we ask that you limit yourself to one question and a follow-up and then return to the queue if you have additional questions. We will do our best to answer as many questions as possible in the time we have a lot at this morning. During the question-and-answer period, please provide your name and that of your firm to the operator. Prince, please open the call up for questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Matt O'Connor from Deutsche Bank. Your line is now open.

Matt O'Connor

Good morning.

Greg Carmichael

Good morning.

Matt O'Connor

Thanks for all the clarity on the guidance for the fourth quarter and I appreciate you don't want to give anything explicit on 2020 relating to costs, but you did say you're mindful of kind of the tougher revenue environment. And I was hoping if you could just talk about some of the puts and takes as we think about 2020. And I'll put a couple out there, the easy ones out of the other way. And like you obviously got the full year benefit of the MB cost saves, which will drag for minimum wage. But remind us kind of where you are in some of the investment cycle, whether it's related to technology or some of your expansion efforts, how those might compare next year versus this year.

Tayfun Tuzun

Yes. Thanks, Matt, for your question. Just the MB comparison also need to take into account the fact that we will have four quarters with MB expense base versus three quarters in 2019. So I just want to point that out. And obviously, the MB picture is intact and we will deliver those cost savings. In terms of the drivers of the expense page that we are now looking at as we are building our 2020 plan, the tech investments clearly are underway. I think we've done quite a bit to improve our infrastructure and focus on customer-facing tools this year that will continue into next year.

Our expansion plans, whether it's related to retail expansion in the Southeast, which is mostly financed by closing branches in the North as well as prudent geographic expansion in commercial, we are still keen on moving on because those are our long-term growth drivers and we've had good success in the efforts over the past two years.

Having said that, I think those decisions, the incremental investment decisions will be made with the environment in the background. And we also look to improve the productivity of the existing expense base. When you think about it, we had about a $4.4 billion total expense base on an annual basis. About $2.3 billion of that is in headcount-related expenses. That's salaries, benefits and other headcount expenses. So we need to make sure that we get the productivity out of that expense base appropriately, and that should continue to provide some ability to fund those incremental expansions from savings on the expense [indiscernible] $0.5 billion of that $4.4 billion total expense base is in equipment and occupancy, and we continue to focus on efficiencies there.

And about $400 million of that is in pure IT cost, away from headcount-related IT cost. So these areas still will give us the opportunity to look for efficiencies as we continue to prudently and selectively invest in the company. But the revenue growth is strong, and we believe that despite the fact that we will have challenges associated with the rate environment, the fee-based and the diversified product and service offerings will continue to support that revenue growth into 2020. So that's the color that I can give you today. But again, we've been very focused on positive operating leverage over the past two, three years. And that's still in our minds as we are building the 2020 plan.

Matt O'Connor

Okay, that's helpful very detail. Thank you.

Operator

Next question is from John Pancari from Evercore. Your line is now open.

John Pancari

Good morning.

Greg Carmichael

Good morning, John.

Tayfun Tuzun

Good morning.

John Pancari

Just on the acquisition on MB. I know there's been some press about departures, banker departures going to competing banks. And I just wanted to see if you could talk a little bit about what you have seen on the bank upfront because I know some of the reports were including other departures that were unrelated. And have those departures been consistent with your expectations or have they exceeded? Thanks.

Greg Carmichael

John, as I mentioned – this is Greg. As I mentioned in my prepared remarks, the execution against the expense synergies is going as planned. The large part of that expense synergy obviously was personnel. So you absolutely expect some of that personnel to move to other banks. We fully expected that. I would say, right now, 90% of all the high performers that we targeted retaining from a banker perspective are still with the bank today. So we have not lost those. And it's very much in line with our expectations that we've modeled in.

And there's probably a little more to come as we continue to work towards our expense synergy numbers, but you would expect that both in the back office and some of our sales force. So we bring the two companies together, look at our gearing ratios and what we need in that market while those bankers basically didn't have opportunities with Fifth Third and end up with another bank. So you're going to have banks want to tap that a little bit, but that's to be expected and within our modeling for this transaction.

John Pancari

Okay, great. Thanks. That's helpful. And then just separately, I appreciate all the guidance you gave on the loan side and everything. So really, I just want to ask about demand, what you're seeing in your markets right now, if you are seeing any erosion in confidence on the commercial borrowers' side. I mean we have seen some macro data that would support the view that there could be some moderation, whether it's ISM or CapEx or whatnot. So if you can give us a little bit more color on what you're seeing, that would be helpful.

Lars Anderson

Yes. So this is Lars. Frankly, I've been in the market a lot recently. And I have not seen any improvement, I don't believe, in terms of the perspective of our clients relative to the economic environment. I'd say that we can continue to see a very heightened level of concerns and uncertainty with tariffs, global slowing, a lot of growing uncertainty now in

Washington around public policy. These are all laying heavily on our clients' minds. And certainly, we're taking that into consideration as we look at the market environment, which we do with the – operating in the fourth quarter and in 2020.

So with that said, we're very pleased with the investments that we've made. We had a very, very strong – in fact, the strongest quarter a commercial loan growth in the third quarter. We did have offsetting that, utilization rates back off about 140 basis points. That's about $1 billion swing in terms of our outstanding. A good portion of that, however, were positioned very well. As you know, we've invested in our capital markets platform, in particular, in FRM, our bond underwriting and distributing.

And frankly, we are well positioned to capture a lot of that. That is a portion of the record level of capital markets fees that we recognized in the third quarter. So it's not always just about the balance sheet in outstanding loans. It's about helping your clients. Depending upon the current economic environment and with our broadened capabilities, we well positioned ourselves to do that. So frankly, I feel very confident about the future for our company given the investments that we've made and look forward to continue to execute against our opportunities.

John Pancari

Thanks, Lars. Appreciate it.

Operator

Next question is from Ken Usdin from Jefferies. Your line is now open.

Ken Usdin

Thanks, guys. Good morning. Tayfun, I was just wondering – thanks for giving the color on where the NIM could settle out. How can – how is it going to work with the purchase accounting from here just given your current schedule? And then how CECL might change the expected contribution from that us to think about next year? Thanks.

Jamie Leonard

Hey Ken, it's Jamie. That's actually a very complicated question. The first part is very easy. Purchase accounting, we were at $15 million in the second quarter and increased to $28 million in the third quarter just given the higher CPRs. We're forecasting again that assuming zero prepayments, that number will be about $15 million fourth quarter. And in the first quarter, there's roughly $150 million of PAA left to go. So that part is fairly straightforward.

The more complicated part in terms of how the seasonal impact all of this, the PAA really shouldn't be impacted. However, the impact on income recognition from PCI loans is still being evaluated. The big four accounting firms are still having discussions with the FASB in terms of whether that should be – continue to be recognized on an effective yield basis or recognized more on a cash flow for those that would need to go to non-accruals. So quite complicated with no official answer yet. So we'll provide more guidance once we hear back.

Ken Usdin

Okay, got it. And then just follow up just on the deposit side. I believe you guys talked about 15 basis points to 18 basis points interest-bearing cost decline in the fourth. It's a healthy beta on the way down. Can you just talk about what's happening on the deposit front in terms of product pricing and your confidence in getting that type of response across the deposit base? Thanks.

Jamie Leonard

Yes. We think and are confident in our ability to deliver a 40% beta on the three moves, July, September and October. That full beta will actually be realized through the end of the first quarter. And what we've done from a rate perspective is, midway through the third quarter, we reduced our go-to-market rates on the retail side. From a 1.5% offer, we pulled it down to 1% because, as we've said before, we really aren't interested in competing with online banks or attracting hot money.

And so no not all of our peers move their promo rates during the quarter. And that's why we were able to deliver the reduction that you see in the third quarter of 2 basis points but are confident that will continue into the fourth quarter. And then on the – from the CD side, we talked about this last quarter. We've got about $1.9 billion of CDs to mature at a 2% rate in the fourth quarter. And our go-to-market rate right now is roughly 1.2% and there's another $2 billion in the first quarter. So from a retail perspective, we feel very good about the steps we've taken and that those numbers will materialize. And then on the commercial side, large portion of that deposit is indexed. So as those rate cuts occur, we'll realize that. So again, we think our strong market share in the majority of our markets allows us the opportunity to move a little bit earlier than perhaps some of our peers can deliver those deposit reductions.

Ken Usdin

Great. Thank you, Jamie.

Operator

Gerard Cassidy from RBC, your line is now open.

Gerard Cassidy

Good morning.

Greg Carmichael

Hey Gerard.

Gerard Cassidy

Tayfun, can you share with us – one of the things I think investors and the analysts are trying to get their arms around is next year's CECL, so called day two number. The day one number which you gave us, the amount of capital or the amount of reserve, that will go up when you guys change to CECL. And you pointed out on the legacy portfolio, 30% to 40% increase. Is that a rough idea of what we can think of provisioning going forward in day two, that provisions under CECL could be as high as 30% to 40% higher than what they would have been if CECL was not implemented? Or is that just way off base?

Tayfun Tuzun

Well, Gerard, it's a difficult question to answer because clearly, there is going to be dependence upon what the economic scenarios are and how each portfolio is growing because as many banks have said and we're seeing the same thing, clearly, the pressure on the commercial side is much less compared to the mortgage side and the consumer side.

And also there are different – as you consider the full life of that product, there are different phases that are governed by the economic scenario outlook for the first few years and then there is a regression back to normal and then back to normal historically. So it is difficult to answer. We are still working on finalizing the models. And I'll be able to give obviously a lot more clarity as we move into the first quarter. But I think there is a decent chance that provisions will go up based upon where that growth is coming from relative to today.

Gerard Cassidy

Okay, thank you. Greg, you pointed out in your opening comments that acquisitions are not a priority right now. And you look at the big merger we saw this year between BB&T and Suntrust and you look at the stock performance of those companies the day prior to the announcement today and they've outperformed the bank index. Would you guys consider a merger of equals? Or what would make you think about something like that in the future?

Greg Carmichael

First of all, Gerard, we're – from a responsibility perspective, we have an obligation to our shareholders and our Board to assess any opportunity that makes good business sense for our shareholders. So if an opportunity of that nature emerge, we will discuss it. We will look at it. We'll make the right decision for long-term benefit of our shareholders. At this point right now, we have a lot on our plate, completing MB Financial, the organic growth strategy we have.

We're very pleased with the performance of the franchise. We don't think we need to do anything but continue to invest in our business and grow our business and deliver on the results that we're talking about today. But once again, if something did emerge of that nature, we would consider it as we would be required to. But at this point right now, we are not interested in an acquisition. We're focused on driving the outcomes we're looking for through an organic perspective of our business.

Gerard Cassidy

Great. Thank you for the color.

Operator

Next, Peter Winter from Wedbush Securities. Your line is now open.

Peter Winter

Good morning.

Greg Carmichael

Hey, Peter.

Peter Winter

Can you give an update on credit? Obviously, nice decline in non-performing assets. But I was just looking at the increase in net charge-offs quarter-to-quarter, which should be fairly stable in the fourth quarter and then this reserve build and then finally just what's happening with criticized loans.

Jamie Leonard

Yes. Let me make just a short comment and I'll turn it over to Frank for more color. I mean we've always said that at these very low levels of charge-offs, there is going to be small variations. But we're still in the teams in terms of commercial charge-offs and very much in line on the consumer side. The other thing that I want to point out is the consumer charge-offs, if you're looking at the year-over-year comparisons, we had a charge-off portfolio sale last year. So that lowered the absolute rate last year.

In terms of the provision bills, really, I mean for any given portfolio when you think about it, if you sort of compare the economic environment at the end of June to the economic environment at the end of September, the background is different then. So the 2 basis point increase in reserve coverage is really more reflective of that. And I'll turn it over to Frank for any color on the actual sort of portfolio trends here.

Frank Forrest

Yes. Hey Peter, yes, good question. Just some perspective. When you think about reserve builds, one thing to keep in mind. This quarter, as you look at it, we had a $35 million build. Of the $35 million, $28 million was unfunded on the funded portfolio and $7 million is on increases in reserve for unfunded commercial commitments. When you go back and you think about 2018, for example, we had reserve releases of $122 million. We said at that time and we said over subsequent quarters that we were at an inflection point.

Tayfun has mentioned that several times this morning. We have been at an inflection point. Our numbers have been historically low across the board. We're really sort of still at an inflection point. Our non-performing assets are below 50 basis points. That number if you compare it to the median reported peer numbers is better than the peer. We expect that to stay stable. That's an important number. Our charge-offs are well within our risk appetite. We expect that to remain there. We haven't changed our guidance at all.

When you think about criticized assets, we're watching criticized assets closely. The third quarter included the results of the shared national credit exams for banks. We included that in our numbers. We did have a blip up in criticized assets. One particular large corporate credit was involved in that. We don't see any loss and that credit has been restructured. Where we saw an increase in criticized assets has really been in sort of core middle market. And so when you look at core middle market, those ones tend to be secured loans and backed by guarantors.

And so we don't see any particular trends or patterns related to geography or more risk type that's totally concerning to us. If you think about our large corporate book and you think about commercial real estate, those are books that typically have a lot of volatility in a market. Our criticized assets are below 3%. Both those portfolios are very well underwritten, very stable portfolios. Our leverage book is performing well. We've reduced it by 50% in the last three years. So all the work that we've done to change the mix of this portfolio is still reflected in our results today. And so yes, we did have a build in the third quarter. We did that because we wanted to take a very conservative view of where we are, that the market has changed a bit in the third quarter and we do live in a world that Lars was talking about where our borrowers are more on edge now than they have been before.

Tariffs are taking an impact on the weekend customers, are not really having an impact on strong customers. So as I step back and think about it, 2018, we had a significant release. In 2019, for the most part, it's been stable. We took a look in the third quarter and we bumped it up a bit. We think it was the prudent thing to do. We manage this book conservatively, and I think it's been reflected clearly in our results over the past two to three years. And our outlook has not changed. So I'm still very comfortable with where we are. And I'm very comfortable with the positions we've taken to change the outlook of this company going forward relative to repositioning the portfolio in a much different manner than we did in the past.

Peter Winter

That's great. Very helpful, really helpful. Tayfun, on expenses, I know you're not ready to give 2020 guidance. I'm just wondering with the full quarter – I guess fully realizing the expense saves by the first quarter next year, could you say expenses in the first quarter, you would expect to be down from 4Q?

Tayfun Tuzun

Today, it's very early to be able to give you that perspective, Peter. The difference between the run rate just with respect to the MB portfolio from the fourth quarter to the first quarter is about $20 million. So on a run rate basis – because on a run rate, about $65 million – 255 million divided by 4 gives you about a $65 million to $70 million type of number. And then we're going from 80% realization to 100% realization. And then our first quarter is always the high quarter because we have the VC numbers and the FICO numbers, all that stuff. So let us wait a little longer to give you that color. But as I said, we are very focused on making sure that we deliver the right expense numbers for next year given the background on the revenue side.

Peter Winter

Thanks, Tayfun.

Tayfun Tuzun

Yes.

Operator

Next question is from Brian Foran from Autonomous. Your line is now open.

Brian Foran

Hi, good morning, everyone.

Tayfun Tuzun

Good morning, Brian.

Greg Carmichael

Hey, Brian.

Brian Foran

So – and one follow-up on CECL. I'm almost reluctant to ask because my understanding is tenuous at best. But my understanding was to reflect a double-count benefit where CECL had lifetime reserves and then the old PCI accounting had marks on these acquired loans. And then – so you're effectively reserved twice. And then that reverses through the P&L as the loans mature. So is your comment that it's unclear how that double-count benefit will work? Or is the comment that double-count benefit might not actually be there?

Tayfun Tuzun

Well, we will have to wait for more clarity throughout the quarter. And I'm hesitant to give you more guidance at this time. But what I pointed out to was that from a pure CECL impact perspective, the current methodology does not provide a mechanism to convert a non-PCI discount into the CECL reserve number. That really is more of the impact on a day one basis. But let's wait until the first quarter so that we can give you a bit more clarity on that.

Brian Foran

Fair enough. One small follow-up. I still get a fair amount of questions on GreenSky from investors. I mean it's such a small piece of your book. I sometimes wonder if there are Fifth Third investors or GreenSky investors who are asking it. But could you maybe give us an update, where does the loan book stand now and any thoughts on the growth trajectory going forward?

Tayfun Tuzun

So the loan book stands at about $1.4 billion. Clearly, incremental growth this year came in lower than we expected because the prepayments in the portfolio are overwhelming a preset level of originations. If you remember going two years ago, when we first announced the partnership, we thought by now we would be at $2 billion, which was the back-end goal. And so in terms of the portfolio metrics, credit is behaving as we expected and the margins are behaving as we expected and the margins are behaving as we expected.

And the company clearly announced a period of time in which they will be evaluating different strategies and we are waiting for that. And depending upon in what direction they choose to go, we will make our own decisions based on how we see those loans benefiting our balance sheet. So I think there's still probably some questions that need to be answered because – before we can give you a clearer direction on GreenSky levels.

Brian Foran

Thank you for that.

Operator

Next question is from Erika Najarian from Bank of America. Your line is now open.

Erika Najarian

Hi, good morning.

Tayfun Tuzun

Good morning.

Erika Najarian

So despite a solid quarter, the stock got down at the open, and I'm wondering if some of that is the hope the market had that you'd provide a little bit more directional, if not specific clarity, in expenses. So I guess I'm going to try one more time. If I take out the impact of a March 22 close and I just look at consensus numbers or expectations for revenues starting in the second quarter of 2020, it seems like consensus is expecting flat year-over-year revenue growth from the second quarter of 2020 onwards.

And I'm wondering that given your message for positive operating leverage, if after the seasonal increase in the first quarter, the message really here is that if that is really the revenue outlook that will transpire in 2020, that the expense base would have to go down from that $1.117 billion in the fourth quarter.

Tayfun Tuzun

Yes. So I think the trajectory of the revenue outlook we gave you some perspective on our margin expectations in 2020, a 5 basis point difference depending upon when and how much the Fed decides to cut, if they decide to cut. But we still expect a decent level of fee income growth. We've seen good income growth this year in fees, and the investment should continue to provide support for better fee income growth going forward than our – in the last couple of years. And I'm very hesitant to give you more clarity than that in terms of the revenue side, and we will manage the expenses accordingly.

And I think we are very focused on making sure that the expense base does not move away from us as we look at that revenue trend. And our teams are very focused, and we have about six weeks to eight weeks in front of us here to finalize our plan, and we are optimistic that we will be able to provide good guidance to you guys in January. In terms of what the market was expecting, the – what we guided in July, it's playing out for the second half of the year, very much in line with our guidance. The NIM, it came down a little bit more than we expected based on the rate movements.

But in terms of the revenues, we had a great third quarter obviously, and that is capturing pretty much what we expected from the second half. And with the mortgage seasonality upon us moving from third quarter to fourth quarter, it is difficult to build upon this very strong third quarter in fee income and project even higher fee income in the fourth quarter. So we're mindful of that, and a couple of transactions on the capital markets side and advisory side came in, in the third quarter. But in general, our outlook was strong for the second half of the year, and we are now actually showing a very strong second half performance.

Erika Najarian

Okay. And so the follow-up question is – thank you for giving a clarity in terms of your net interest margin expectations for next year. And Jamie, I'm wondering – I wanted to clarify, that range of 3.2% to 3.25%, that includes two rate cuts from here. And if that's the case, then the contribution from the $4 billion in hedges should be a positive $40 million annualized, with LIBOR at $150 million is included in that size.

Jamie Leonard

So the guide we have is the cut in October plus two more in 2020, March and September. And in order to help – let's just look at all of the hedges that we have in place from a cash flow perspective. So our cash flow hedges in the first three quarters of 2019 made about $2 million. Over the next five quarters, if those rate cuts play out, those $11 billion of hedges are going to make $155 million. So that's $15 million in the fourth quarter, and then the rest spread out across 2020.

So that's really the backdrop for our confidence in the NIM overall, not compressing going forward the way you saw it in the third quarter. We just unfortunately did one-year forward-starting swaps, and we probably should have done seven-month forward-starting swaps to protect the third quarter. But when you look at first quarter of 2019 versus first quarter of

2020, our guide is that NIM would be down 5 or 6 bps with those July, September and October cuts, and I got to believe that's going to be best-in-class performance over that period of time.

Erika Najarian

Got it.

Tayfun Tuzun

Our NIM results, actually, Erika, when you look at the cumulative change in NIM this year, we are ahead of our peers. I mean it's been a very, actually, very good performance for the first three quarters of this year when you look at it on a cumulative basis. Also when you look at it, as people are guiding now for the fourth quarter and the way we are guiding for the fourth quarter, in 2019, NIM performance is very strong.

Erika Najarian

Understood. I think that the market maybe thinking that industries generally top ticking on fees. I don't think the skepticism is over, actually, your net interest income. I think it's a combination of just the industry top ticking on fees and then sort of what the expense management fallout will be from there. But I very much appreciate all the detail on NII. Thank you.

Operator

Next question is from Saul Martinez. Your line is now open.

Saul Martinez

Hey guys. I'll ask another question on CECL, just a pretty popular topic on this call. Your reserve rate shows about, I think it was 104 basis points this quarter. With the CECL reserves 40% to 55%, that will take you more or less I think to about 150 basis points, ALLL ratio. Do you expect your growth going forward, the balance – your growth in balance – loan balance is to – on average, under the CECL methodology, come from products that have higher or lower than 150 basis points lifetime losses.

Tayfun Tuzun

Yes. Good question. So when you think about the portfolios that are driving a higher percentage of CECL reserves, Residential Mortgage, we have, at this time and probably in the near to medium term, have no plans to grow the Residential Mortgage book. Home equity loans have been in decline now for a number of years. That's another portfolio that is carrying a high percentage. And then sort of other consumer loans, inclusive of GreenSky loans, also carries a higher percentage.

So those – all those three portfolios will probably display a relatively lower growth rate compared to other loans on our books. And commercial, clearly being our largest portfolio, getting back to a more normalized level of commercial loan growth would indicate that perhaps that day one percentage would be overstating the incremental impact on reserves.

Saul Martinez

Yes, got it. So I mean, under the CECL methodology, your commercial, especially your C&I, I would think would be – I don't know if materially, but it should be much lower than 1.5%. And just the normal – ALLL ratio should gravitate down at that as…

Tayfun Tuzun

Everything else being equal, including the economic scenarios that are being applied to that is a reasonable assumption.

Saul Martinez

Yes, okay. Got it. Thank you. On – and I guess I want to go back to NII and specifically on deposit betas and deposit prices. It seems like you have good visibility in terms of the betas on the rate cuts for July, September, October. But if I look into next year, if we do get a margin in the September cut, I mean, how confident are you with those 40% betas on future cuts? Because – and I asked because if your guidance comes to fruition, I calculate that your deposit costs – interest-bearing deposit costs are going to be probably in the 80 basis point range, probably lower – obviously lower, all in. It just doesn't seem like there's a lot of room for deposit costs to come down from these levels given the low jump-off point, and deposit costs are already low relative to short-term rates from a historical standpoint. So I guess the question is if rates do continue – short rates do continue to come in, maybe even more than what you're expecting, how does the deposit beta outlook change?

Jamie Leonard

Yes. This is Jamie, Saul. You're right in that our fourth quarter forecast, our interest-bearing core deposits is in the, Saul, mid-80s basis points of cost. And then that number coming off of the other rate actions we would take, plus a March cut, we'd be into the 70s of that point in time. We still think there's opportunity to operate at a 40% beta on the next couple of cuts. But certainly, once you're beyond those cuts and if you had more in 2021, you would start to bump up against some of your deposit floors and some of your products.

So we model all of that in our interest rate sensitivity tables, and that's where you see that when the Fed starts cutting 100 or 150 basis points that the outcomes aren't as productive as on the first couple. But I think for the foreseeable future, the next three or four cuts, the 40% beta is a good number for us.

Saul Martinez

And are those cuts – are those betas coming pretty – are they pretty balanced between retail and commercial? Or are they…

Jamie Leonard

No, it's very barbelled, where retail right now, we think from July, September, October, will be in the 25% to 30% range, and commercial will be – and our Wealth & Asset Management group would be in the 60% range. And that's similar with what we saw on the way up the 225 basis points of fed hikes.

Saul Martinez

Right. Okay, got it. Thank you very much.

Operator

Next question is from Mike Mayo from Wells Fargo Security. Your line is now open.

Mike Mayo

Hi, can you hear me.

Greg Carmichael

Hey, Mike. How you doing?

Mike Mayo

So three things which we can observe: your expenses are controlled; the MB Financial closings took place; and tech is a priority. So we can see that. So can you just give us some more understanding of what's happening under the hood as it relates to technology? Like do you close three of the four MB Financial data centers? So how many data centers did you have at the peak? How many do you have now? And where do you think that can go? And then maybe how many apps did you have at the peak? And what happened pre and post-merger with MB Financial? And anything else on technology, such as the cloud and what percent of the apps you might want to move to a public cloud?

Greg Carmichael

And Michael, I'll try to answer that question in the order in which you asked it. First off, from a technology perspective, obviously, we've invested in technology as other banks have done that. But we really like the returns we got from those investments. If you go back in 2007, just look at our central operations, and you look at 2007 to 2019, we grew that expense base 1% over that 12-year period of time. And we're $30 million bigger in assets, and this will be more in transactions. We focus a lot of our technology investments in operational efficiencies, back-office capabilities, artificial intelligence capabilities to better serve our clients.

We're getting paid well for those type of investments. We'll continue to do that as well as our customer-facing opportunities, where we continue to leverage technology to improve the way we serve our customers and reach our customers and the effectiveness from a cost perspective of how we talk to those customers. In addition to that, we're investing in cybersecurity as you would imagine, with fraud. If you look at our fraud losses, we're down year-over-year. I would tell you, very few of our peers like are down year-over-year. Because of the investments we made in technology, we get paid well for that.

So we'll continue to do that at the right pace in how we think about it. As far as data centers go, we run with two data centers. We'll run in the future with two data centers. Those data centers, I think, are about 200 miles apart as a requirement from a conduit perspective. And right now, with MB Financial, there's two additional data centers that we'll close down and consolidate into our operations. Most of their applications will consolidate onto our applications, and most of their applications were eliminated, except for those applications that were supporting their asset base lending platforms and their leasing platforms. Everything else, for the most part, is consolidated into Fifth Third, and the majority of that is complete.

So we got work to do on the cleanup of the data centers, as you would expect, but that's all part of the plan and part of the numbers we explained to you, and we'll absolutely execute well on getting that done. With respect to the cloud, listen, we don't just move applications from our legacy to the cloud in current state. If we have the opportunity to reengineer an application and it's suited for the public or private cloud, we'll then move it to public or private cloud. We do use a public cloud. We do use private clouds. But at the end of the day, it's really based on the application. We're very mindful of the risk, so we're very mindful with the applications. Do we allow it to be in that cloud environment.

So we're really diligent about how we think about our infrastructure. A lot of our investments are also around remonetization of our technology infrastructure, our legacy platforms, to make them more agile so we can move more quickly in this digital age. So we'll continue to do that. And the cloud's part of how we do that, but we're less concerned about how many apps we have in certain areas. But if you just move a current application up into the cloud, it's probably going to cost you more money to operate. Okay?

Mike Mayo

Yes. I guess just that last comment was interesting. And as far as data centers though, where were you at peak? And just to be clear, you have two data centers. You have two more with MB Financial. You have four or…

Greg Carmichael

We got four data centers, Mike, and we'll go back down to two.

Mike Mayo

Okay. So you will have four total data centers when you're done.

Greg Carmichael

Yes.

Mike Mayo

And how does that compared…

Greg Carmichael

Mike, we'll have two data centers when we're done. We had two going into the merger. MB had two. We'll consolidate their two onto our two, so we'll have two at the end of day.

Mike Mayo

Okay, great. So two data centers.

Greg Carmichael

Right.

Mike Mayo

And how does that compare – and look, you have the tech background. You know this stuff. I mean, how does two data centers for a bank your size compare to peer? Or how many total data centers does the industry have? And why do so many banks not give this information when we ask? So I appreciate you giving this to us.

Greg Carmichael

Yes. I mean first off, two has always been, in any business where there was prior days, in the manufacturing sector, two data centers is the more optimal way of running it. You have to have the space to prep the leaser off different grids and so forth from a telecom perspective, but two is the optimal way for us to run our business, and that's what we've – how we've operated it. That's where we're most efficient, we get the best leverage of our talent and our resources and our use of our capabilities. So more than that would not make sense for Fifth Third or most companies, I believe, but that's how we see things. And we'll consolidate, once again, the two MB onto our current two legacy of Fifth Third data centers.

Mike Mayo

All right. Thank you.

Operator

Next question is from Marty Mosby from Vining Sparks. Your line is now open.

Marty Mosby

Thanks. Good morning. I have three quick questions, and then I want to kind of dive into my little deeper subject. But if you get into first three, your capital and your buybacks, you bought about $350 million this quarter. You're kind of foreshadowing $300 million per quarter. I thought there was kind of an overhang of past gains that you could have a catch-up this quarter. So I was curious why it went a little bit higher in the share repurchase in this particular quarter.

Tayfun Tuzun

Yes. Good question, Marty. The $300 million per quarter is probably a good directional guidance. What we did was, as you remember, at the beginning of this year, we were thinking that we would probably be going towards a 9%-type capital number, but we chose to actually be at the upper end of our target, at more like 9.5%. So we had the Worldpay gains that still remain, that we executed in the first quarter. We decided not to execute the buybacks related to that. That's about $200 million or so in gains that we've kept on the balance sheet. That's the difference that you're seeing.

Marty Mosby

Okay. And that's – keeping that going forward, you want to keep that higher capital ratio, so that's there?

Tayfun Tuzun

Yes. For now, in the near term, that's probably a good target.

Marty Mosby

Okay. And then you showed a schedule on preferred dividends kind of oscillating between 33 and 17. Is that going to be the pattern going up and down each quarter given the semiannual payments on Series H?

Tayfun Tuzun

Yes. More or less, that's what's going to happen, and then it would change as any of the preferreds reach their fixed period and move to floating, but those are a few years off. So for the foreseeable future, that's a good pattern.

Marty Mosby

Okay. And then I just wanted to bring up a point on purchase accounting. You have the uptick this quarter from 15 to 28, and then you have the reserve build of 50. So when you look at those two things, the reserve build more than offset this uptick in purchase accounting accretion. And those are kind of tied because as you're taking those loans out as they're prepaying and then coming back in as a normal loan, you're having to kind of rebuild reserves on loans that were in purchase accounting accretion. So there's an actual – not a real benefit this quarter from this transaction or this kind of process. There's actually a negative weighing on the quarter that kind of releases as you go into next quarter.

Tayfun Tuzun

Yes. Marty, I don't think those two are necessarily connected to each other. Clearly, the higher prepayments have resulted in a higher purchase accounting accretion number for the quarter, but the build is not necessarily on MB loans. So it is a broader environmental factor that takes into account many other variables in our ALLL methodology. So I would not connect those two together.

Marty Mosby

If they're not connected, there's some offsetting going between the reserve build that's negative and positive in the purchase accounting accretion.

Tayfun Tuzun

I would still say that they are not connected to each other.

Marty Mosby

Right, got it. Now going into CECL again. One, I wanted to answer Gerard's question. I think we're missing a little bit of math, so let me kind of give you what my thought is and then get your response. The thought that you increased your allowance by 30% or 40% and that your day two provisioning costs are going to be 30% to 40% higher, does it work out that way for this reason? If you look at your allowance over the last five quarters, you had provisioning of $475 million; you had net charge-offs of $409 million, which represented 85% of your loan loss provisioning. So that doesn't change day two. You're still going to have to cover your losses. What you're going to have increased is, the 15% of what you paid over the last year in loan growth goes up by 30%. So you could go from 15% to 20% of your allowance that's related to loan growth, which would be at that higher ratio because you're going to have the higher reserve level that you're going to have to maintain. So it's only the incremental part on loan growth that goes up by 30%, 40%. That's not your total amount of loan loss provision that you have every quarter because that's really mainly related to the losses, not the allowance ratio. Does that make sense?

Tayfun Tuzun

Yes, it does. And I think there – the second question, I think, was Peter or somebody else asked the question in terms of what that incremental number is based on the growth dynamics that we would see in our portfolios. So what you're saying is correct. And on top of it, which portfolio growth also has an impact on that provision, that is purely related on incremental loans.

Marty Mosby

Yes. So if you had the exact same mix of loans, you would keep the 150 ratio. So instead of providing at 105, you're going to be providing at 150. So just on the incremental loan growth doesn't go up 30%. Your whole loan loss provision doesn't go up 30%. Losses are the majority reason for loan loss provisions, so the net charge off ratio still will be the main driver for your loan loss provision.

Tayfun Tuzun

That is correct. I interpreted Gerard's question in the same unit in terms of just applying it to incremental loan growth. So…

Marty Mosby

Yes. But Gerard was kind of get lost in that and assume – they kind of think although that means our loan loss provisioning has to go above that amount, it really doesn't have to. And the only thing I was going to leave as a guidance and just for everybody in the industry to kind of think about is because of day two, don't think of day one as a real good chance to round up our allowances because we never get this back. This isn't an allowance like we had in the past, where you kind of can build it given your economic belief of what's going to happen and then eventually kind of recapture that. This is a true to life, through the cycle kind of provisioning.

So rounding up on the CECL is just going to more volatility and higher provisioning that really never gets realized until you actually liquidate your bank. So actually being conservative in a sense of rounding up. In our mentality, we've been trained to do that for so long. It's not a good answer given the way the accounting is going to be different day two as we move forward. So I'll just encourage everybody to not just think of this as – I've heard so many people say, "This is our chance to round up allowance to prepare for the recession." This thing won't give you any benefit as you into that recession. So it's not a reserve you're getting benefit from. So anyway…

Tayfun Tuzun

Thanks for that fact. I think that's very helpful, Marty.

Greg Carmichael

Thank you, Marty.

Marty Mosby

Thank you.

Operator

Next question is from Vivek Juneja from JP Morgan. Your line is now open.

Greg Carmichael

Hey, Vivek.

Vivek Juneja

Hi. Sorry, I'm going to get a little more prosaic. Just a corporate banking line item. You mentioned lease remarketing. Can you tell us what the gain is on that for this quarter?

Tayfun Tuzun

Yes. That lease item, Vivek, includes more than just remarketing. Because remember, we now have two new leasing businesses under our hood, LaSalle leasing and Celtic leasing. So it's a broader number. There were just some leverage leases that paid off during the quarter. And I think that number was, I don't know, in the single digit, upper single-digit number, something like that.

Vivek Juneja

Okay. Okay. Great. And that number, given that you're doing more in leases, it was likely to be more volatile going forward as a result, Tayfun?

Tayfun Tuzun

There is some volatility associated with the underlying business, especially on the technology side, which is dependent upon the timing of the technology contracts that are coming due. But in general, I think the trends will be positive. I think we expect that line item, as we are also now investing more in that business, to continue to grow. We may see some seasonality going forward. And – but in general, I think the trends will be up.

Greg Carmichael

Yes. And I will just add, as we continue to build out our equipment finance kind of [indiscernible] frankly in the regional banking market with MB joining us, our strength in syndicating these transactions has grown significantly. We've got some great talent there, and we would expect that, that will continue to grow in the future.

Vivek Juneja

Okay. Great. Second question, just wanted to clarify the numbers that I think Frank may have put out. Criticized assets, Frank, was it 3% criticized assets to loans? Or was it – did I get that not correct? Or was it up 3%? And how did – what was the change linked quarter?

Frank Forrest

Let me talk in terms of classified assets, which is probably better than criticized assets. Classified assets are loans that are rated substandard. Criticized assets include loan that have potential problems, but they're not well-defined weaknesses at this point in time. Our classified assets were up 5% of the quarter. And again, as said before, they fluctuate quarter-to-quarter up and down, still well within our risk appetite, within our tolerance.

Vivek Juneja

Okay. And has that increased, as you said, mostly from the shared national credit exam results?

Frank Forrest

No. It actually was more in the quarter – on the classified, it was actually just more on our quarter middle market. That's a granular portfolio, and as said before, it's a portfolio that is the well secured. So while the level of the problem loans goes up, it doesn't change our outlook relative to nonperforming or the loss in a material way.

Tayfun Tuzun

Yes. I think the SNC portfolio levels, and I don't have the actual numbers in front of me, but they're almost like 50% in terms of these credit metrics, where theirs is classified criticized, they are well below the broader portfolio credit metrics. So…

Frank Forrest

Yes. I mean that's right. And what I did mention before and maybe what you reflected on, our large corporate book, which is the Shared National Credit portfolio, for the most part, a level of criticized assets in that entire book is under 3%, and that's maybe what you were referencing. That's a fair number. And the same goes for our commercial real estate portfolio, was under 3%, which is where the banks have had the preponderance of their problems over the past decade or so. So those are books we manage very carefully. We feel very, very comfortable with the overall asset quality. So I think that was in response to your question.

Vivek Juneja

Yes. Okay, thank you.

Frank Forrest

Thank you.

Operator

Next question is from Christopher Marinac from Janney Montgomery Scott. Your line is now open.

Christopher Marinac

Hey, thanks. Just wanted to ask about the talent pool in Chicago and the turnover that has happened with MB. Is most of that behind you? And are you confident with kind of what's happened on backfill with your staff.

Greg Carmichael

First off, as we said earlier, the true rate that we've seen so far is exactly what we modeled in. 90% of all of the outperfomers that we intended to keep we offered position to work still at the bank. This is normal with respect to an acquisition in the market by a larger bank. There's individuals that we didn't offer positions to that are going to shop to other banks. A lot of that's what you're seeing right now. We're getting close to the end of that tail, all right, and we feel very comfortable about the talent that we have to serve that market, the talent that we retain. As I've mentioned in our prepared remarks, we had very little client attrition associated with this transition.

And Chicago was one of our strongest production markets in core middle market across all of our regions this quarter. So we feel really good about the talent that we have. And once again, to get $255 million of expenses on your job, a lot of that is people-related expenses. So you would expect those individuals to shop for other banks. And I know other banks have [indiscernible] is having success recruiting against entity. But that's just part of this process of consolidating two financial institutions. You're going to get some of that attrition, which is to be expected and planned for.

Christopher Marinac

Great, Greg. That's very helpful. Thanks very much.

Operator

There are no further questions. I'm turning the call over to Chris Doll.

Chris Doll

Thank you, Prince, and thank you all for your interest in Fifth Third. If you have any follow-up questions, please contact the IR department, and we will be happy to assist you.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.