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Citizens Financial Group, Inc. (CFG) CEO Bruce Van Saun on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-18-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.98 beats by $0.02 | Revenue of $1.64B (4.73% Y/Y) beats by $12.28M

Earning Call Audio

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Citizens Financial Group, Inc. (NYSE:CFG) Q3 2019 Earnings Conference Call October 18, 2019 9:00 AM ET

Company Representatives

Bruce Van Saun - Chairman, Chief Executive Officer

John Woods - Chief Financial Officer

Brad Conner - Head of Consumer Banking

Don McCree - Head of Commercial Banking

Ellen Taylor - Head of Investor Relations

Conference Call Participants

Ken Zerbe - Morgan Stanley

John Pancari - Evercore

Scott Siefers - Sandler O'Neill

Brian Foran - Autonomous

Matt O'Connor - Deutsche Bank

Saul Martinez - UBS

Gerard Cassidy - RBC

Erika Najarian - Bank of America

Ken Usdin - Jefferies

Peter Winter - Wedbush Securities

Marty Mosby - Vining Sparks

Operator

Good morning everyone and welcome to the Citizens Financial Group, Third Quarter 2019 Earnings Conference Call. My name is Brad and I will be your operator today. Currently all participants are in a listen-only mode. Following the presentation, we will conduct a brief question-and-answer session. As a reminder, this event is being recorded.

Now I'll turn the call over to Ellen Taylor, Head of Investor Relations. Ellen, you may begin.

Ellen Taylor

Hey, thanks so much Brad, and happy Friday everybody. We're really pleased to have you all join us. First off this morning, our Chairman and CEO, Bruce Van Saun; and CFO, John Woods, will provide an overview of our results and our outlook and they will reference the earnings presentation which you can find at investors.citizensbank.com, then we'll be happy to take questions. In the ring with us today are Brad Conner, Head of Consumer Banking; and Don McCree, Head of Commercial Banking and they will be able to provide some additional color.

So now for some quick housekeeping, our comments today will include forward-looking statements, which are subject to risks and uncertainties and you should review the factors that may cause our results to differ materially from the expectations on page two of the presentation and in our 2018 Form 10-K. We also utilize non-GAAP financial measures, so it's important to review our GAAP results on page three of the presentation and to utilize the information about these measures and the reconciliation to GAAP in the appendix.

And with that, Bruce, it's all yours.

Bruce Van Saun

Alright, thanks Ellen. And good morning everyone, thanks for joining our call today. We're pleased to announce another strong quarter. In spite of interest rate yield curved headwinds we grew our revenue 5% versus a year ago and 1% versus last quarter.

Our earnings per share was up 5% versus a year ago and up 2% sequentially. The key to these results were strong performance in our mortgage business, continued good expense decline and robust capital return.

We progressed well on our efforts around TOP 6 and on some of the strategic investment initiatives that we outlined last quarter. We continue to actively manage the balance sheet through our BSO program and we've maintained our loan-to-deposit ratio of around 94%.

We've managed deposit costs down aggressively in the quarter with interest-bearing deposit costs down 6 basis points versus last quarter and we expect the deposit betas to tick up as we see further rate cuts.

Our credit metrics remain strong overall and both consumer and commercial are in really good shape. Our view is that the economy is holding up reasonably well, but growth has slowed somewhat versus a year ago. While we don't see a recession on the horizon anytime soon, we are being duly cautious in selective areas on new loan originations.

So overall, I'd say we've executed well year-to-date and we feel we are positioned to close out the year with a good fourth quarter. Our formula for 2020 will remain consistent, namely grow our balance sheet prudently, deftly manage our NIM, continue to invest in our fee businesses and reap the returns, carefully manage the expense base by finding fresh efficiencies and then self-funding new initiatives, stay disciplined on credit and actively manage our capital base.

We celebrated an important milestone during the quarter, the 5^{th} Anniversary of our IPO on September 24. It's been quite a journey. She's made much progress in building a great bank and we are now delivering better and better for customers, colleagues, communities, shareholders and regulators.

We know there is more work to do and we are energized by the challenge. I'm confident that our track record of strong and disciplined execution will continue and will differentiate us from our peers, and there's no reason the next five years can't be even better than the last five.

With that, let me stop and turn it over to our CFO, John Woods.

John Woods

Great, thanks Bruce. Good morning everyone. We are pleased to report a strong quarter with record fee income, good expense discipline and continued execution against our strategic initiative. Let me kick off by covering important highlights of our underlying results on page four.

On a year-to-date basis our EPS is up 11%, and for the quarter we delivered EPS growth of 5% year-on-year with PPNR up 2%. This reflects relatively stable net interest income at 3% loan growth helped offset the impact of the decline in net interest margin to 3.12% given rate and yield curve.

We delivered record fee income of nearly $500 million, up 19% year-over-year illustrating a diversity of our business model. Commercial and consumer loan growth were each up 3% year-over-year as we seek attractive variance to deploy capital and grow our customer base.

Strong deposit growth is faced by continuing momentum in Citizens Access, which grew to $5.6 billion by quarter end. Our spot LDR was 94.5%, providing us with funding flexibility as we head into the end of the year.

Given the environment, we remain highly focused in our spend discipline and continuing to execute extremely well on our TOP programs. We now expect to realize a per tax run-rate benefit for our TOP 5 programs in the range of $105 million to $115 million by the end of the year, which is a $10 million increase over our prior estimates.

Overall credit quality remains strong with a stable non-performing loan ratio of 57 basis points and an allowance-to-loans ratio of 107 basis points. On an underlying basis the effective tax rate is 22.3% as the reported rate of 20.5% includes a $10 million tax benefit associated with an operational restructuring. We delivered underlying ROTCE of 12.6% and tangible book value per share was up 14% year-on-year to $31.48.

This quarter, there was some noise in several line items due to an aircraft lease restructuring in a non-core portfolio. This was trigged by a client merger and reflects our continuing efforts to accelerate the run-down of the non-core lease portfolio.

This reduced PPNR by about $3 million, with an increased expense of $10 million and a $7 million increase in fees. Charge-offs and provision were $5 million higher due to this transaction. Before the impact of this restructuring, we delivered positive operating leverage of 40 basis points in linked quarter basis and an efficiency ratio of 57.8%.

On page six, net interest income was relatively stable year-over-year despite the impact of the challenging rate environment. Loan growth of 3% helped largely to offset the impact of a 10 basis point decline in net interest margin to 3.12% given the rate backdrop.

Contributing to the decline in NIM was a 3 basis point impact year-over-year from higher premium amortization tied to significantly lower long term rates. This was partially offset by the benefit of higher interest-earning asset yields, given the continued mix shift for better-returning assets and modestly higher short-term rates.

On a linked quarter basis the margin decreased 9 basis points, including a 3 basis point impact on premium amortization. So on a positive note, we managed deposits well with a 6 basis point decrease in interest-bearing deposit costs.

Given the challenging rate environment, we have continued to actively manage our asset sensitivity which came in at 2.7% to a gradual 200 basis point rising rate versus 2.9% in the prior quarter. Year-over-year our asset sensitivity has come down which was driven by an addition of approximately $7 billion of net receive fixed swap over the past four quarters, including a net $2 billion forward sliding position we had at this quarter, as well as evolving expectations for balance sheet mix.

As you look at the effect of our hedging activities over the last year, both our balance sheet mix changes had the effective of shifting our sensitivity to the long end of the curve, with about 20% to 25% of our exposure now five and six months and shorter.

Our current outlook has an additional rate cut in October, however we expect to see a lower level of wind compression in the fourth quarter reflecting further declines of interest-bearing deposit costs, broadly stable premium amortization, and the benefit of our hedges. These factors along with an expected resumption of loan growth should help support net interest income in the fourth quarter.

Moving to fees on slide seven, as I mentioned, our fee-based businesses delivered record results this quarter with fee income hitting 30% of revenue. Non-interest income was up 7% on a linked-quarter basis and up 19% year-over-year, driven by strong results in mortgage banking, card fees and foreign exchange and interest rate products.

Service charges and fees were up $2 million, or 2% linked-quarter reflecting seasonality and card fees were up 5% sequentially driven by seasonally higher volumes. Our acquisition of Franklin is playing out as we hoped, and serves as a nice hedge against the backdrop in lower rates.

Mortgage banking fees were up $55 million, as the origination business led the way with production revenue up $31 million on higher volumes and improved gain-on-sale margins. Overall mortgage servicing revenue increased $24 million, given favorable MSR hedging results and our larger servicing portfolio.

Capital markets fees came in at $39 million this quarter, which represents the lowest level since first quarter of 2018, in the face of overall market weakness. Even so, we improved our market share and positioning.

Syndication fees were down linked quarter, reflecting the impact of a significant slowing in middle-market activity and seasonality, while bond-underwriting fees were higher as fixed income markets picked up later in the quarter.

We are entering the fourth quarter with a strong overall capital markets pipeline, which includes the impact of several deals that were pushed out from third quarter to the fourth quarter. Wealth fees were 6% lower linked-quarter from record second quarter levels, as investment sales were impacted by volatile market conditions.

In FX and interest rate products we executed exceptionally well despite challenging conditions, delivering near record level fees in line with second quarter in what is typically a seasonally slower quarter.

We are pleased with the progress we’ve made diversifying our fee revenue by broadening capabilities, executing well on strategic initiatives and integrating key acquisitions to build scale in mortgage, expand our M&A business, and enhance our wealth capabilities. And as we look forward, the investments we have been making across the platform over the past five years should continue to gain traction, as we seek to do more for our customers and be their trusted advisor.

Turning to page, eight. Underlying non-interest expense was up $10 million linked-quarter, reflecting the impact of the lease transaction. Excluding this impact, expenses were flat, illustrating our strong commitment to expense discipline as we continue to deliver efficiencies from our TOP programs. We continue to recycle cost savings from TOP into revenue-generating opportunities.

Salaries and employee benefits remained relatively stable, and equipment and software expense was up 3%, given our ongoing technology efforts. Compared to the prior year, underlying non-interest expense before the impact of acquisitions, and the lease restructuring was up 3% as we efficiently managed our costs, while investing for growth.

Let’s move on to page 9 and discuss the balance sheet. Average loans were relatively stable linked-quarter largely reflecting the impact of second quarter loan sales, as well as relatively high repayments and lower line utilization in commercial.

Year-over-year average loans were up 3%, driven by growth in both commercial and retail with some modest headwinds from asset dispositions. Adjusting for the impact of loan sales in the first half, loan growth was 4% year-over-year.

Commercial loans were up 4% year-over-year with strength in C&I and were down slightly linked-quarter due to relatively high repayments and the impact of lower line utilization, as well as planned reductions in commercial leases. On the retail side, loans were up 3% year-over-year and 1% linked-quarter, given growth in mortgage, education refinance and our merchant finance partnerships.

Regarding the lease restructuring this quarter, I should mention that we have done a nice job running down the non-core leasing portfolio and the total non-core book, which are both down about 30% year-on-year while the overall credit quality of the book continues to improve. Overall, period-end loans were up 1% linked quarter, providing momentum for fourth quarter loan growth.

Moving to page 10, we saw nice deposit growth of 1% linked-quarter and 6% year-over-year. We continue to benefit from our Citizens Access digital platform, which has contributed nicely to our funding diversification and the optimization of our deposit levels and costs. At the end of the quarter, we reached $5.6 billion in Citizens Access deposits.

Given the rate environment, we have been aggressively executing our deposit playbook to manage down our deposit costs across all channels, reducing CD rates, retail money market promo rates, and taking down the savings rate in our direct bank. We've also been reducing rates for some commercial clients where they come.

As a result, our total deposit costs were well controlled, down 5 basis points linked-quarter, a nice improvement from the 3 basis point increase last quarter. Interest-bearing deposits were down 6 basis points linked-quarter.

Next, let's move to page 11, and cover credit, which continues to look quite good overall. This reflects an improving risk profile in retail and I'm relatively stable risk profile at favorable levels in commercial.

Net charge-offs came in at 38 basis points in the quarter, up modestly from relatively low second quarter levels. Net charge-offs were up $27 million year-over-year with a $16 million increase in commercial, largely driven by a small number of uncorrelated losses, as the broader portfolio risk profile remained relatively stable.

Retail net charge-offs increased $8 million, reflecting expected seasoning in our growth portfolios. Provision for credit losses of $101 million was up from prior quarter and prior year levels reflecting the higher charge-off. The non-performing loan ratio of 67 basis points was relatively stable linked-quarter and improved 6 basis points year-over-year.

Non-performing loans decreased 5% year-over-year, driven by improvements in retail. On a linked quarter basis, non-performing loans increased 3%, driven by an increase in commercial primarily tied to a small number of loans, while we saw improvements in retail driven by home equity and education.

Our allowance to loans coverage ratio remained relatively stable, ending the quarter at 107 basis points. The NPL coverage ratio was also stable linked quarter at 159 basis points. On page 12, we maintained our strong capital and liquidity positions, ending the quarter with a CET1 ratio of 10.3%, which compares well with peers and gives us excellent financial flexibility.

During third quarter, we repurchased 14.1 million shares of common stock and including dividends we returned $662 million to shareholders, up 25% year-over-year. Going forward, we continue to target a dividend payout ratio of 35% to 40%, and our planned glide path to reduce our CET1 ratio remains on track.

Let’s move to page 13 and discuss CECL. We expect that the day-one impact for CECL on a pro forma basis will be about a 30% to 35% increase in the existing reserve, which was about $1.3 million at the end of the quarter. From a capital perspective, this represents about 22 basis to 25 basis points of CET1 on a fully phased in basis, or approximately 5 basis to 6 basis points in year one. This range considers the current economic outlook and mix and credit characteristics of the portfolio.

In addition a key factor is the impact of longer duration loans such as education, home equity, auto and residential mortgages that tend to attract a higher level of reserves. At the same time, the commercial portfolio is generally shorter duration and so is expected to require less reserves than it does today. Ultimately, the impact of the initial impact will reflect both the portfolio mix and the macroeconomic outlook when we get to the end of the year.

On page 14, I want to highlight a few exciting things that are happening across our Bank. First, we ranked Number 4 in the 2019 J.D. Power U.S. Home Mortgage Satisfaction survey. Since last year, we moved up six positions in that survey, which is a real testament to the hard work our mortgage colleagues have done to integrate Franklin American, while relentlessly focusing on our customers.

We are also very excited to announce that we've just entered into a new Consumer Banking partnership with an iconic technology company to be announced shortly. We will provide more details around the launch of this program, which is later this quarter, but this is another great example of our commitment to innovation and strong focus on the customer experience.

In commercial, we are really progressing well with the client migration to accessOptima, our best-in-class cash management platform. About half of our clients are on the platform and we expect the transition to be complete by the end of the year.

And in addition to TOP 5, which I mentioned earlier, substantial work is under way on our TOP 6 program, which is targeting a pre-tax run rate benefit of about $300 million to $325 million by the end of 2021.

Our outlook for the fourth quarter is on page 15, and it reflects continued disposition for both our top and bottom line results. Our current view is that we expect an additional rate cut in October, and as a result, we expect net interest income to be relatively stable in the fourth quarter, as loan growth should offset further but less net NIM contraction due to rates.

Our outlook for loan growth reflects stronger period-end trends, coupled with healthy pipelines driven by our geographic, product and client focused expansion strategies. Also, we expect a moderation of third quarter commercial pay-down and utilization trends, as well as continued growth in mortgage, student and other retail.

We are expecting non-interest income to be down modestly from the record level last quarter. Strength in capital market revenues should largely offset a decline from record mortgage fees. Given our continued focus on expense discipline, we expect non-interest expense to be flat to slightly down.

Additionally, we expect provision expense to increase by about $10 million, and finally we expect to end the year with a CET1 ratio of approximately 10.1%.

To sum up on page 17, our results this quarter demonstrate our continuing strong performance, as we execute against our strategic initiatives, grow customers and revenues, carefully manage our expense base, deploy new technologies and improve how we run the bank.

Now, let me turn it back to Bruce.

Bruce Van Saun

Okay, thanks John. Operator Brad, let's open it up for some Q&A.

Question-and-Answer Session

Operator

[Operator Instructions]. And we'll go to the line of Ken Zerbe with Morgan Stanley. Please go ahead.

Ken Zerbe

Great, thanks. First of all, great job on reducing your interest-bearing deposit costs this quarter. We've heard from other banks that deposit competition is still really aggressive. Bruce, I know you mentioned that you expect your deposit betas to increase next quarter, does that imply that some of that deposit competition might be easing?

John Woods

Yeah, I'll go ahead and start off. I think it's a number of factors. I mean, when you have a rate cut like we had in September, it was just a natural operational lag, if you will, and we talked in previous calls, that there is a deposit lag that maybe, call it three months to six months. And so as you, as we get further away from that September cut, the impact of that cut gets pushed through operationally and you going to see deposit betas increase from 3Q into 4Q, and therefore, we expect interest-bearing deposit costs to actually decline by a larger amount than they did this quarter.

Ken Zerbe

Okay, great. And then just my second question is in terms of your energy exposure. We had three other banks that I cover announce higher energy charge-offs this quarter. And I know you guys didn't mention it at all, which is certainly a positive. But can you just address what you're seeing from a credit perspective in your energy portfolio?

John Woods

Yeah, so Ken [Inaudible]. We've actually been working through our energy exposure for little over a year now. Our NPLs are way down, they are down about 25% of our total NPL to 9%. So we structured and worked through a lot of them. Our overall portfolio is down and I think one of the things that we have in our portfolio, I don't know about other banks, but have a very low service of other field services and that's a lot of the distress. It looks like it's happening in the oil sectors. So we tend to be – the RDL structures are good midstream structures and we are pretty comfortable we don't see any incremental distress in the portfolio, although it is a bit of a distress.

Ken Zerbe

Alright, great. Thank you.

Operator

And we can move to the next question with John Pancari with Evercore. Please go ahead.

John Pancari

Good morning.

John Woods

Hi, good morning.

John Pancari

I wanted to see if you can give a little bit more color on the commercial credit front. I know your commercial non-performers were up 25% linked quarter and you noted in the release that it's a small number of uncorrelated credit. So just wanted to see if you can give us a little bit more detail on the industry, on maybe the sizes and the types of loans as well. Thanks.

DonMcCree

Yeah, I'll take that one. So we did have a couple of charge-offs in the quarter. One of the real estate divisions which is a regional mall was at a small net charge-off to basically position ourselves and hopefully exit out of that credit with the sale of the restructuring in the near future.

Our non-pro forma move was making one credit which is in the automotive linked sector, which we've been working through, as well as we don't think there is a significant charge-off there when we took a non-performer, and that non-performing is restructuring. We were able to do that a year ago. There is a significant amount of used capital for wallets now. We can all pay back the credit than we thought it was to take a non-performer given the cash flow dynamics of the Company.

Bruce Van Saun

I would add with what Don mentioned on that first credit, we're close to having that one resolved, which would allow NPAs to fall back down in Q4.

Don McCree

I think more generally, I think as John said, we feel good about the general trends in the portfolio. We feel like we're identifying any issues earlier. We're aggressively addressing them and we are trying to move them off the portfolio. We certainly think there's future risk. So we try to move through anything that portfolio we think will have any significant...

Bruce Van Saun

Yeah, be proactive. Good model.

John Pancari

Okay, got it, got it. And then Bruce, you indicated in your remarks that you're being cautious, prudently cautious in certain lending areas. What type of areas are they and what do you see that's making you get more cautious? Thanks.

Bruce Van Saun

Well, I can throw that one to Don as well, but I'll kick off here, but I think in general there’s some very competitive conditions in certain parts of the market, particularly middle market. We have a lot of non-bank competition there and so we're competing where we want to hold up our relationships with our customers, but we're not being aggressive to try to grow the book there and take on a tough spread situations or tough term situation, so that's one.

I think in certain areas like restaurants, we're certainly actually taking a posture toward reducing exposure and not adding exposure, and I think we're also being proactive there and we have some good momentum there.

So I'd just say it's around the edges of being disciplined and then seeking out areas of growth, our specialty verticals. We get some better spreads there, we're moving upmarket and competing effectively in mid-corporate. So we think we'll see some growth there and I think we did indicate that we will see a return to overall loan growth in Q4 and also in commercial in Q4, so our pipelines look quite good.

We have seen in Q3 elevated pay downs, refinancings, lower line utilization. So even though we had a pretty strong quarter in terms of originations, we are fighting against that a little bit, but I think in Q4 we would expect to see less of that and we're continuing to see a nice pipeline.

Don, you can add.

Don McCree

Yeah, I'll just give you a little more sense to that. Kind of a year ago we were seeing about two-thirds of our origination, they were basically one-to-one this quarter. So we really got hurt on the new originations side from pay down.

I think it was a combination of things going on. I think particularly in the middle market in general, we see people deleverage in anticipation for uncertainties in the next year. So they are not putting on some more debt. There’s not as many special dividend deals going on, there’s not as many relief in capital or buy back I assume in the core of our portfolio, and that is obviously people just saying, we are going to take the utilization down.

Our keen sense is some sense of that moderating, so now we've got some of our loan growth going forward. As Bruce mentioned, some of the challenging portfolios are restaurant portfolio, down by about 50%, but we are working with the fee and we are working that down. We are purposely letting our leasing portfolio down and focusing on our core. We've been working our multi-family real estate portfolio down, so there's a lot of things that we're actually trying to adjust from a portfolio standpoint, but it’s the lagging the numbers on a net basis.

And then, as you've heard John talk about, we are actively involved in the BSO and where we don't see adequate returns over the next say two years to three years. Our disposals we have, we'll consider moving them off the balance sheet. So I think the new business feels good in areas that we've actually grown from a regional standpoint, from an industry specialty standpoint, it feels good, and it's just there's a load of investment going on in terms of the overall book-to-business we are trying to run. And just that I know, it is very competitive, people tell us, people search for loans that are out there and we [inaudible] on both the terms and conditions at a pricing standpoint, so we can make payments in the future as well.

John Pancari

Okay, thanks for taking my questions.

Operator

And we'll go to the next question in queue coming from Scott Siefers with Sandler O'Neill. Please go ahead.

Scott Siefers

Good morning, guys. Thanks for taking the question. Maybe John, first question that's for you. I'm hoping you can just put a little bit of a finer point on the fee guide for the fourth quarter, including some of the expected drivers. You mentioned capital markets in the pipeline there, but I guess I'm just curious, given that, I guess a pretty substantial MSR benefit, so right off the bat it could be kind of a $25 million hole or up to a $25 million hole. Just curious if you can talk a little bit more detail about the puts and takes please?

John Woods

Yes, sure I'll start off and others can add. I mean I think the main point here is that, as we mentioned that capital markets pipelines were quite strong. When you look at 3Q, that was a little bit more of a down quarter at $39 million. When we see the outlook in to 4Q, we have some deals push out of 3Q into 4Q; we had a very soft syndication quarter in 3Q that looks to be firming up into the fourth quarter.

M&A advisory was an area that was flattish from 2Q to 3Q and we look to see that being meaningful and significantly up in the fourth quarter. So I'd say that when we tend to look at this in the early part of July, we looked at our pipelines and how that would play out in 3Q and now we're looking at the pipeline in early October here, and it bodes well for a really nice rebound in capital markets.

I should also mention that service charges in card, you know which had a nice quarter in 3Q looked to be up a bit further. And trust, I mean I think there were seeing choppy market conditions that impacted trust and investment services and I think you'll see that our expectations are that that will improve going into the fourth quarter too. So it's a couple of different levers that will all tend to have an impact into 4Q that largely offset as we said, the mortgage decline.

Scott Siefers

Okay, perfect, thank you. And then a broader question just on rate sensitivity. You pulled back a little bit of the asset sensitivity this quarter as well. I'm wondering if you could just comment on whether there's a sort of an end goal as to where you want the company's rate positioning to be? I mean obviously it's kind of tough given all the volatility in rates, but just what the broader long-term thinking on rate sensitivity is at this point.

John Woods

Yeah, I mean I think you've seen us pick our asset sensitivities down over the last year and I think that we've been prudent on that front. As you know, a commercial bank has a natural asset sensitive profile, and the derivatives and other techniques to frankly dampen that profile. So I think you would see us in a low-to-moderate asset sensitive position over time, maybe converging toward neutral as we see, as we get toward the end of the even cycle if you will and so I think we're getting pretty close to a stable place.

We do like and have the view that we are at historically low long-term interest rates. We changed our sensitivity from a majority exposure to the short end of the curve. Over the last year to now the majority of that exposure is the long end of the curve. So we have a view over time that long end of the curve will arrive and we've executed our hedging activities with that in mind, and with a general sense that we should take some asset sensitivity off the table and that's just on the net interest income line.

As you know, mortgage provides a very nice overall revenue lift then its rates declined by a lot, which is what happened in the third quarter. So it's not just our derivatives and not just our sensitivity on it, net interest income. We look at how we try to preserve revenues overall and you saw the power of that diversification in the third quarter.

Scott Siefers

Perfect! Alright, thank you very much. I appreciate it.

Operator

And next in queue we've got Brian Foran with Autonomous. Please go ahead.

Brian Foran

Hi, good morning. I wonder if just conceptually on net interest margin once the Fed stops, you know I guess we're yet to decide when that is, but let's say it's mid 2020 the Fed stops seizing, you know there is one school of thought that the banks could actually get a little bit of a bounce back in margin because of the deposit re-pricing lag you mentioned and that will catch up. And then there is another worry that, well the assets don't all re-price immediately and you're still going to have that kind of rollover of fixed rate assets to lower rates.

I guess as you think about it, not getting into the basis points of what the actual margin is going to be, but just conceptually, when the Fed stops, is your bias kind of a roughly stable margin for up on the deposit re-pricing or still some pressure on the asset yield rollover?

John Woods

Yeah, I mean I'd say a couple of things. I mean, I think you mentioned the deposit lag and I think that provides a tailwind. Once you get three to six months, that's helpful.

I think it matters where loan rates are. As I mentioned earlier, if the Fed gets to the end of the dealing cycle, and we end up with a deposit yield curve, I think you could see some positive impacts in net interest margin over the, call it two, three, four, five quarters out into 2020, and so that's an important aspect. I mean, I think that front book, back book dynamic, given the fact that we are roughly split 50/50 with a fixed loan portfolio and a floating loan portfolio, you're right, that when rates fall, we get the immediate impact on the floating part of the portfolio. But the fixed part provides that buffer.

And if we can see some lift on the long end, you could see stabilizing to rising NIMs as you get three months to six months beyond a Fed moving cycle. So I think you'll see some stabilization here over the next quarter or two, and with those dynamics I mentioned, possibly even some luck when you get toward the end of 2020.

Bruce Van Saun

The other thing I would add also is that if we get a little more loan growth, which we expect in the fourth quarter and to be able to sustain that in 2020, that facilitates more BSO actions in terms of kind of the loan side of the balance sheet, and so hopefully that will kick in and then be accretive to our NIM as we go through 2020.

Brian Foran

Thank you. One small one and I don't want to jump into the weeds, but on page 20 of the supplement, I've had a few people ask about this negative $48 million in the provision for unfunded lending commitments. Can you just talk through, was that a lease or was it more like a transfer because a loan drove down? What drove that negative $48 million provision for unfunded lending?

John Woods

Yeah, for the question and looking at our supplement.

Brian Foran

I didn't look at it. Someone else pointed it out to me.

John Woods

So yeah, it is exactly as you mentioned. We had an unfunded loan where over time we built the reserves on the unfunded part of the reserve in the ACL if you will, but all of the provisioning reserves happened while it was unfunded and then once it is fully reserved, it's funded and then got transferred and needed to get transferred over to the [inaudible] overall, that is the law really the driver was a transfer of an unfunded fully reserved loan that...

Bruce Van Saun

Exactly it was a backup letter of credit.

John Woods

Yeah.

Bruce Van Saun

Ultimately drew down and we moved it over.

John Woods

Yeah, I think they released them, because they moved the analysis there as well.

Brian Foran

Great! Thank you, Bruce.

Bruce Van Saun

Sure.

Operator

And we'll go to the next question in queue that will come from Matt O'Connor with Deutsche Bank. Please go ahead.

Matt O’Connor

Good morning.

Bruce Van Saun

Hi, good morning.

Matt O’Connor

Fees were obviously strong this quarter and you gave some pretty good granularity on your thoughts on the fourth quarter, but just looking out more medium term, can you talk about the magnitude of fee growth you think you can generate and some of the drivers. I mean obviously it's incrementally important from here given the pressures on the interest income and I'm trying to maybe quantify the growth that you expect against some of the drivers. Thanks.

Bruce Van Saun

Well, I think Matt, I'll start. Of course John can pick up, but when I think about where we've been and how we've grown through time, we've pretty much been growing commercial fees probably high-single digits, keeping pace with reasonably robust loan growth over that period. And that's reflective of the investments that we've made in building out the platform, hiring some great bankers, standing up our own global markets FX and interest rate business, investments in the cash management business, acquisitions of M&A shops and I think we're really just gaining traction and reaping the benefits of those investments. So I would expect to see continued good growth on the commercial side. Q3 was a little bit of an air pocket. We think, Q4 is going to be a bounce back quarter.

On the consumer side, we've had a harder time growing. I think we addressed some of those issues. We've been investing organically and building out the sales force and coverage folks in wealth and in mortgage, but I think the acquisitions that we've done, particularly mortgage, looks very timely in light of being able to catch the refi wave. But I think there's a lot we can really do with that business. So it's really scratching the surface of its potential in terms of building out more tools for the correspondent and wholesale customers that we have.

So I think we can grow our market share there very nicely and then get better penetration into our branch channels as we continue to add those out. So even though we came off a high with the refi wave, I think that will continue some through Q4 and early into the first half of 2020. But there is other levers to continue to, I think gain market share in the mortgage business. And then, while we now address the high end of the pyramid with thoughts of -- and we're looking frankly to do more in terms of acquisitions to further that growth on the wealth side.

So you know if we average the commercial and then the slower growth on consumer, I think in the rearview mirror, we probably were in the mid-single digits range and certainly would think that, that's a goal we could set going forward when we think out a number of years to at least be able to continue to do that.

Matt O'Connor

That was helpful. Can you just elaborate on the type of course, maybe the size of wealth deals that you'd be open to? I think you did relatively modest.

Bruce Van Saun

Yeah, I think all of these deals we've described is bolt-ons and I think what we really need to make sure of is it has a good strategic fit that the company has a great culture that's going to mesh well with us, and that we can get attractive financial terms. And I think if you buy smaller, you can get a little better handle on all of those things. If you buy bigger, it's a little harder to achieve those three objectives. So I would think you'll still consider these deals smart, but more in the bolt-on category. So you'd probably need to do several to continue to scale up our business.

Matt O'Connor

Okay, thank you.

Operator

And we can go to the next line in queue. It will come from Saul Martinez with UBS. Please go ahead.

Saul Martinez

Hey, good morning.

Bruce Van Saun

Hi.

Saul Martinez

So wanted to – I know you've addressed this to a certain degree, and I know there's a lot of volatility and then price and seasonality in this, but can you just give a little bit more color on how we should think about what a more normalized run rate is for mortgage income, assuming the long end of the curve stays where it's at.

You had I think $80 million of production revenue which is very strong, the MSR valuation gain. As we think about that going forward, how should we think about the sort of the moving parts there and what it could trend to not only in the fourth quarter, but just beyond that?

John Woods

Yeah, thanks for the questions, it’s John here. I'd say when you break that down into three P&Ls right, and we talk about production and servicing and then the MSR valuation net of the economic hedge right, so when you go across each of the three, going forward, I think you could see production being –you know production P&L basically coming down a bit in the fourth quarter, but I would call it higher than where it was in the second quarter. We had a good quarter in the second quarter here, phenomenal quarter in the third quarter.

So I think maybe coming off those high, but kind of stabilizing at higher level than what we've seen in the past in production, we're really excited about that. Very strong production, really strong margins, which is important to how we generate those revenues and just a growing integration of the Franklin platform. So that's how I see that part of the P&L.

I'd say a similar comment on the operating servicing part of the P&L, where they were having a routine with UPB that is -- that was previously being sold by this platform before we acquired it. So our servicing UPB is growing nicely, as well as the servicing fees and employees that they're recognizing on that P&L. So that P&L is stabilizing and rising and we're completing the full integration and insourcing of the servicing platform from -- Franklin was using its in-house’s touch back on to bring it in-house, which will give us more control over data and direct access to the customer, so we're excited about that.

And then the last one, of course is the MSR valuation net of economic hedge. During the quarter when we see large swings in this past quarter, we were positioned to benefit if mortgage spreads were to widen out. When we get to extremes, we tend to moderate positions and assume that they will hover there over time and it did. That's something that I think you could see more of in the future.

And we thought it will jump around a lot, but I think we've demonstrated a really solid job of managing the -- what we've got is otherwise a volatile asset for the last four quarters that we had this big platform, going into the fifth. We've managed that really well with flat to up a bias on the MSR net of economic hedge on.

Bruce Van Saun

And Brad, you might just want to add a little bit some of the innovation and the new technologies that we're delivering in the mortgage business, because I think it's quite exciting what's actually taking place.

Brad Conner

I was actually just going to do that. Just one thing I'll also chime in with John. I think you hit it spot on and one thing to keep in mind, the industry is quite full of capacity right now, and that gives us great optimism around margin maintaining for a period of time.

So the signs are good from a margin perspective. But the point Bruce that you made, we've invested heavily in our digital capabilities in the mortgage business, and so we put a new digital front end onto our origination platform.

This past quarter along where somewhere the older applications come through, the front-end digital platform, which gives us efficiency opportunities for one, but also gives us more opportunity to build a direct-to-consumer -- the direct-to-consumer side of the business.

We also invested in digital capabilities on the back end of the business with our digital and mobile servicing application. We're seeing a lot of our customer’s transition over to using that digital platform on the back end, so a lot of good things happening other than just a rate environment. I mean I think the integration as you said has gone extremely well and we're starting to reap the rewards of investments that we made and the digital capabilities in the service slate.

Saul Martinez

That’s great. Thank you, that's great color. If I could switch gears and also ask a question on reserving and on CECL specifically. I mean the day one impact is not a big deal from a capital standpoint. How do we think John about the day two impact of CECL, because a lot of your growth, if you look at the balance growth over the last year, a relatively large portion of it is coming from education, it is coming from other retail lending that tends to either have longer tenures or higher loss content than others, and obviously has a higher provisioning load as you originate those loans. How do we think about the loan loss provisioning outlook in light of that loan growth and mix shift into 2020?

John Woods

Yeah. I mean I think so we just you know kind of come out with our first real quantitative outlook for where this adopting standard will affect us in early January. So I mean I would say a couple of things, but also caveat that we have more work to do and we're continuing our parallel runs and completing all the validation of our models.

So with all of that said, I think there are two big forces that you have to think about. One is, with all of those portfolios that are longer duration, we have we have a big back book and the way -- the dynamic that we're dealing with is the fact that we're being asked to reserve over the entire life of the entire back book for those longer duration loans in early January.

And so going forward, if our models are reasonably accurate and reflect the future, which is a big question for all banks, then really the provisioning for that entire back book is really behind us and is really already up on the balance sheet.

Saul Martinez

Yeah.

John Woods

So what your left with us is the other side of the ledger, which is the front book and the front book originations that you have to basically put through P&L, all of the reserve that will likely run.

So I think for portfolio by portfolio, the gearing of ratios if you will, the benefit of the fact that the back book is no longer being provisioned, which would otherwise have been provisioned in an incurred loss model under the existing standards is now going to be already handled and probably closer to zero against the magnitude of the front book.

And I think the answer with respect to whether that's positive, negative or neutral is varied by portfolio and that's going to play itself out.

Bruce Van Saun

Yeah, and what I would say just to add to that is that we're working through our three-year strat plan that we finished in July. So you kind of overlay portfolio by portfolio what the interplay between those dynamics that John described, back book, front book and then how does that play out from an accounting standpoint over say the next three years.

There may be certain product twists that we're offering a longer duration version of a loan and they may not make as much sense. We might tweak something, but I would say that at the end of the day the economics are the economics and the your accounting something we have to contend with.

So we’ll get on top of it and then obviously when we do our guidance in January in the next call, we'll be able to take you through that in some more detail, but we're working at it, we're analyzing it and I think we feel broadly fine about it.

Saul Martinez

Got it, alright. That's very helpful, thank you very much.

Bruce Van Saun

Yeah.

Operator

And next in the queue we will go to the line of Gerard Cassidy with RBC. Please go ahead.

Gerard Cassidy

Thank you. Good morning, Bruce and John.

John Woods

Hi.

Bruce Van Saun

Good morning, Gerard.

Gerard Cassidy

Bruce, you touched on growing the fee revenue and I wanted to zero in on the capital markets business since you guys have had good success in expanding that business and I understand the second quarter if I read the press release correctly was a record level, third quarter came down a bit.

So two questions; one, you mentioned the pipeline is very strong going into the fourth quarter. Can you compare that pipeline to prior quarters, is it higher or lower? And then second, what will it take for you guys to bring this business up to maybe a $70 million a quarter run rate? Is it hiring more people or expanding geographies, how can you grow into that level?

Bruce Van Saun

I'll let Don take that.

Don McCree

I think about – you know, I'll talk about a combination of new lines for the commercial bank activity. So we saw FX and interest rates in that commodity hedging activities for clients mostly running at incredibly strong levels for the last couple of quarters. So that was a little volatile this quarter; they hurt us on capital market side, benefited us on the interest rate and currency side, and we're seeing that continue.

On the capital market side we generally play in the middle market and middle market leverage finance space. And what happened this quarter was that market was laid out a year-on-year and effectively the market was all closed for the last six weeks in the middle of the summer as that changed this interest rate faster. We saw a great lift in September, on the back of an opening for the bond markets and we saw high-yield activities through exponential.

So that all being said, I think that we've got the pieces in place to allow us to take advantage of the opportunities, who let themselves a really big growth area over the next quarter or two in M&A as the acquisitions begin to kick in. So we've been running a cover between core today – attacked the core in terms of M&A fees. Those should go up significantly this quarter and the pipelines look very, very strong.

So our strategy is to get that feel on or even hire a couple of fold. One is, our new business you start high-yield selling trading activity this quarter, which should allow us to take larger positions in high-yield underwriting, plus those transactions would double or triple. So that is not the high-yield side of the business.

We've been building credibility in our loan syndication leverage financing capability over four years and we're seeing larger transactions and more transactions as we build comparable and a reputation for execution with our clients and our investor base. And we're seeing this general activity growing in the fourth quarter. Whether that continues in the first quarter, second quarter, third quarter, it's a little early to say, but I think there is upside on all of those key elements.

The other thing we are trying to do is lower our buybacks. So as we said time, at the time of the IPO, we do need to – in the mid-quarter and new vertical sectors and we've got very strong corporate finance industry advisory themes. So the way we are engaging with our clients, I will report to you saying four, five years ago, it was very much around provisioning credit, and now it's about advice and that we could transition a complex financing and it's only in the last couple of years, we've had [inaudible].

I think as you'll have seen any time in my career and we're just in a lot of very interesting conversations with our client base. So that should give us a good momentum.

Bruce Van Saun

I would just add to that, Gerard. You know we have knocked on the door of $60 million a quarter before. I hate to put my neck on the line, but I think this fourth quarter shapes up potentially to be a record – a new record quarter for us in capital markets, so we're not that far away on that $70 million a quarter.

I don't think we really need to hire more people or acquire another M&A boutique. To get to that kind of a level it would require I think that the markets are healthy and open over the next year, and then some of the investments that we've made, a new approach to how we cover, all of that would have to continue to progress and come to fruition. But there is not, there's is not a lot of incremental investments that we need to make in order to continue to drive higher revenues in this business.

John Woods

And further to that point Gerard, just to the question earlier about pipelines, our pipelines in early October are up across the board, whether you are looking at the combination of syndications and bond underwriting or FX, IRP and M&A in particular, they're all up since early July when we look into early October, just to close that out.

Gerard Cassidy

Great! Thank you for the color. And Bruce, since the BBT SunTrust merger, many investors and myself all thought more deals were going to be announced; obviously nothing's happened. But when you look at the BBT stock, it's outperformed the General Bank indexes. So it looks like the market is supporting that type of transaction. Is that something citizens could ever consider in the future?

Bruce Van Saun

Well, I think the stock answer to that is we're going to always consider anything that benefits our shareholders, but I would say whether that deal proves to be a good one depends on the quality of the execution and so you've had – and I've been part of a big MOE, Bank in New York and Mellon. And the spreadsheets, when you announced the deals always look great and then it comes down to did you make the right personnel decisions, did you get the cultures to mesh and fundamentally execute well, so we'll see if that happens.

I think for us right now, we're very focused on continuing to run the Bank better and we're in a period of very rapid change in terms of customer expectations, new technologies and we're very focused on being on the front foot with our TOP 6 program, some of our strategic investments. I think we can carve a path that's really exciting and fulfilling for our stakeholders by really staying focused on our own current agenda.

One of the risks of getting involved in larger transactions is it can be distracting and take your eye off the ball in a period where you really have to be all over the current agenda. So I mean, those are few thoughts Gerard.

Gerard Cassidy

No, I appreciate your candor. Thank you.

Operator

Your next question in queue comes from Erika Najarian with Bank of America. Please go ahead.

Erika Najarian

Hi, good morning.

Bruce Van Saun

Hi.

John Woods

Hi.

Erika Najarian

I just had one follow-up question. It's really what sort of what Brian Foran was asking earlier. So as I think about what's unique to Citizens as we look out over the next few quarters. You know obviously you've done a lot of work in terms of driving your business momentum upward and accelerating it and second, you do have high deposit costs.

So as we think about beyond the fourth quarter, right, and you're still feeling good about loan growth, you are still feeling good about the economy. And based on the forward curve, should we think that the worst-case scenario for NII next year could be stable? I'm trying Ellen.

John Woods

I mean, I think – Erika, its John. I mean, I think – if you take in for January, it will be – we'll come out with relatively specific expectations for what 2020 will be on NII. But I think you have the broad contours, the direction, correct. I mean we expect -- when you think about where our loan growth has been year-over-year, in the neighborhood at that 4% range, which is a percent or two above GDP.

So next year, we want to aspire to continue to grow the platform at levels that are similar to that or better and that for us, all of the work that we're doing on the net interest margin side of things, I mean, we did have as you know maybe some betas that we're – when we were in a tightening cycle we had some deposit costs rises that were higher, but that's starting to retrace itself here and you'll see high deposit betas rising in the fourth quarter and continuing to reflect the fact that we've done an amazing amount of work on the deposit beta.

Bruce Van Saun

Frankly, we've been outperforming now through the trust cycle on the deposit side.

John Woods

Yeah, so in the second quarter we did and then we outperformed in the third quarter we did and I think you can almost consider a trajectory there that we expect a same paper we did in the fourth quarter. They're going to have a meaningful improvement in the interest-bearing deposit cost decline. So we're excited about that. So I think the key levers will cause that kind of stabilization that you're talking about, but stay tuned. We tend to try to…

Bruce Van Saun

Now, we did for January 1, a good try there. Catch you on to open up a little bit.

Erika Najarian

Yeah. I understand the timing is odd, but it just sounds like if you're relatively stable next quarter with pressure from October, not the underlying pressure from what's happened so far, so quickly, with only taking your deposit costs down the way you did, it seems like – stable seems like a potential for. Just I guess I'm not asking you to confirm that, but that's just how I was looking at that, so I appreciate the color. That wasn't actually a question. I'm going to take myself off the queue now.

Bruce Van Saun

We want to hear other questions. Do you have any questions?

Erika Najarian

Alright, thanks for that.

Bruce Van Saun

Okay. Sure.

Operator

And next we'll go to line of Ken Usdin with Jefferies. Please go ahead.

Ken Usdin

Thanks guys, good morning. Hey, just a follow-up on the overall balance sheet. You guys have shown really good deposit growth in the money market accounts and then the non-interest bearing, and obviously we're starting to see the term deposits come down against that and Citizens Access kind of flattening out.

Can you just talk us through just that mix and how you expect just overall balance sheet to traject from here, especially as loans look to be still growing and securities have kind of flattened out just given where that rate dynamic is? So I guess just talk about the earning asset base and the mix within and how you'd expect that to go forward. Thanks guys.

John Woods

Yeah, I mean I think – so overall you're seeing the fact that we continue to year-over-year we're growing deposits at 6% and loans a bit less than that. So you look at the LDR ratio around 94.5% in the third quarter, that's down reasonably. So were they going to do it – might have did or so about a year-and-a-half ago, a year or year-and-half ago.

So I think the balance sheet strength is quite good, really solid liquidity position as we head into the end of the year. Deposit growth has remained I think greater than loan growth. That gives us optionality in terms of how we execute our playbook in terms of deposit pricing and that's part of how we've been able to drive deposit costs down. You saw all the good work that we've been doing in terms of generating deposits.

On the loan side, we gave you that color about the fact that year-over-year our trends during that 4% range or so, that's something we will aspire to accomplish over time, but deposit costs will continue to fully fund loan growth, and I think that's I mean...

Bruce Van Saun

I think one piece of color I would add Ken is that we're quite pleased that we've been able to grow our demand accounts and outperform relative to peers. Brad, you might want to add some color on that, but really the focus on the mass affluent customer and some of the investments we've made in customer experience and customer journey, we're gathering them, targeting them, getting them in the door, using data analytics and then they stay and so retention is up there and that's really fueling that growth in demand accounts.

Brad Conner

Yeah, I think you've nailed it Bruce. I think we've talked quarter-on-quarter about our investment in analytics and that has given us the ability to really target the right customers, improve the value proposition, which we've done that with a focus on the mass affluent client, which has deepened our relationship with them and that we're getting them active quicker than we were in the past, and we're improving our attrition and our net promoter score are showing that there are much more satisfied customers and we really think that's what's fueling the growth in non-interest bearing deposits.

Ken Usdin

Understood, thanks for that. And one follow-up on the securities book. So the securities book, you mentioned that the premium amortization was a 3 basis point hit to the net interest margin. I'm just wondering at this point, where you able to reinvest cash flows at versus the back book, if we could try to isolate for what's happening aside from the premium then? Thank you.

John Woods

Yeah, I mean I think on the front book, back book trends here, I mean you've got reinvestments in the third quarter. I'll then call it $250 million or thereabouts and you still have a positive front book, back book and securities that run off within the neighborhood of $220 million , $223 million or so. So I think you are feeling – it's like the hint against this backdrop. We've done a reasonably good job of holding our cash and investing and deploying that cash at point during the point in the quarter where they go a little higher.

Yeah, I mean it's hard to do that all the time, but we have a couple of quarters given we've been holding our powder a bit until some of the big declines in rates moderate and then we put all the cash to work. So like I said, we still got a positive, call it 25 basis points or so of front book, back book on the securities portfolio.

Ken Usdin

And one quick one just on the premium then. If rates stay flat, does that 3 basis point headwind just go away, meaning it goes to zero as an increment if you expect, if you realize it on like a realized basis and is there any lag to the premium that we continue to roll forward just because of where rates have gone to? Thanks.

John Woods

Yeah, I think you've hit it, there's a couple of factors. I mean I think our outlook, that is going to be relatively stable quarter-over-quarter, such that the drag of 3 basis points this quarter was because there was an increase from 2Q to 3Q. Our current outlook with, outlook for rates etc. is that that will be flattish from 3Q to 4Q, so therefore no longer a rise. And then over time, you know maybe that can moderate again back to 2020, we'll get back to you on that later, but that'll be flattish from 3Q to 4Q.

Ken Usdin

Understood, thank you.

John Woods

Okay.

Operator

The next question in queue will come from the line of Peter Winter with Wedbush Securities. Please go ahead.

Peter Winter

Thanks. As you guys get ready to implement the TOP 6 initiative, are there any thoughts, maybe that you'd be willing to delay investments or maybe accelerate some of the plan cost savings just to ensure you generate positive operating leverage going forward?

Bruce Van Saun

Well first off, we're trying to get this thing off the ground and we have a number of work streams, basically seven or eight work streams with individual leaders, and as soon as they are good to go and launch, we're already moving ahead. So we've given the green light on two of those work streams already, and we'll have more that will launch in the fourth quarter.

Both of the TOP program is accretive right away. So we want to get those things going quickly. The places where we would be in turn reinvesting the NextGen tech is one of the big work streams. That has probably the most value of any work stream for the bank in terms of how we're running the bank and how they can deliver for customers. But it is somewhat reliant, it doesn't generate immediate savings. It requires some investment and then the savings come later. But as long as the rest of the streams are moving ahead, then our disposition is we've got to move on that; it's really, really critical.

When we announced the TOP 6 program, we also talked about some strategic investments that we were assessing and prepared to make and those include further expansion of services access, our digital bank or our point-of-sale merchant finance platform or new ways to cover small business customers and lower-middle market customers with more digital and data applied and so we're working through those.

I think we have an ability to gauge those based on how fast the savings come through on the other streams and then also the overall macro environment next year and so we do have this commitment that we've held fast to, since the IPO of trying to deliver positive operating leverage, and that's probably the lever that we have, would be to gauge some of those investments. But our objective, our hope is that we can move on those, because I think they're really exciting and I think they really will drive medium-term revenue growth for us.

Peter Winter

Great! That's really helpful. Because I guess when I look at the medium-term profitability targets that you've laid out, obviously the rate environment is much different than when you originally gave that and so I'm assuming you're still expecting to see then continued improvement in the profitability in terms of the efficiency and ROTCE?

Bruce Van Saun

Yeah, I mean that's the only way to really get it, is you're going to have to drive the operating leverage. One of the things to keep your eye on is, if some of these trade tensions and concerns that are holding back the economy a little bit abate, that obviously is going to be a tailwind into next year and that could also result in the long-end of the curve moving back higher.

That's actually been a bit of a crusher when you look at ROTCE, because year-on-year growth in OCI related to the growth in the value of the securities portfolio actually has flipped 75 basis points of ROTCE. So if you had the long end new back, you can actually throw that right back on to the equation. So there's a number of factors there, but yes, commitment to operating leverage key in terms of continuing to drive forward and reach those ROTCE goals.

Peter Winter

That's great. Thanks Bruce.

Operator

And will go to our next question in queue that will come from Marty Mosby with Vining Sparks. Please go ahead.

Marty Mosby

Thanks, and that’s a good question to follow that last question. When you look at banks, there's so many intricate details that we've spent all this time talking about, but really investing in it comes down to three different metrics. One is, return on tangible common equity, the other is dividend yield, and third is basically, how can you -- how fast can you grow tangible value. So while your ROTCE has been under pressure, one statistic that everyone then talked about was your growth and tangible book value was 14% over the last year, which is the counter of that.

So when you look at those three metrics, let's say assuming we don't have a credit event or a credit downturn, how do you see those three metrics moving forward over the next, let's call it, 12 months to 24 months given the environment that we have? Do you see progress on those metrics or where we're at right now is very positive. I think the valuation reflects some deterioration in those metrics, so just wanted to get your take on that.

Bruce Van Saun

Yeah, I mean obviously the objective is to be driving the ROTCE and driving the tangible book value per share higher, and if we execute well and the environment stays okay or improves, I think we will certainly be able to do that. If we do that, the stock should reflect positively, so our dividend yield would go down, which wouldn't be a bad thing. Ultimately we are still committed to raising our payout ratio and getting to a 35% to 40% dividend payout ratio, but the yield obviously is a function of the stock price.

Marty Mosby

And then, John, I want to dive into a very – so from a big picture to a very minutia type of question. Given that what we're seeing is consumer allowances are going up precipitously on the sea-saw and commercials are going down, while that day one impact is the negative for those who have more consumer.

What I'm trying to get at is, as we go into the day two through 200, if the consumer because it's less lumpy and the commercial is getting impacted because of how low we are in the cycle right now and their losses tend to come in in big pieces, is the consumer possibly going to be less volatile over a cycle versus commercial when you have big pieces coming in and out, having to adjust those factors when you go through those economic cycles?

John Woods

Yeah. We're still I would say developing our intuition about this new standard and how the models will work. I think there are a series of factors that impact both sides. I think just the prevailing market conditions and expectations of how you're reasonable in support of the projections will revert over time, I think that has meaningful impact on both portfolios to tell you the truth.

It's one of the reasons I believe we've all been scratching our heads about why this standard is necessary. It is going to be very difficult to compare across institutions for a period of time, and it's going to be a lot more difficult to frankly anticipate where P&L impact will go over time.

All of that said, as you heard earlier, economics are still something that we – something that we have to keep our eye on that ball and we'll deal with the capital impact as necessary. But I don't know that I'm ready to say that one of the two portfolios is going to be less volatile. I think it's possible that either of the portfolio could contribute to significant volatility in any given period and stay tuned to the continuing disclosures that we'll do on this in January, as we finish out frankly our parallel loan and their model validations, which are happening here as we speak in the fourth quarter.

Marty Mosby

Thanks.

John Woods

Sure.

Bruce Van Saun

Alright, Ellen?

Ellen Taylor

Yeah, I think -- operator?

Operator

Yep, no further questions at this time.

A - Bruce Van Saun

All rightie, very good. Well, thanks everyone for dialing in today. We always appreciate your interest and support. Have a great day!

Operator

Thank you and that does conclude the conference today. Thanks for your participation. You may now disconnect.