Operator

Good morning. I would like to welcome everyone to the Goldman Sachs third quarter 2013 earnings conference call. This call is being recorded today, October 17, 2013. Thank you. Mr. Holmes, you may now begin your conference.

Dane Holmes

Good morning. This is Dane Holmes, director of investor relations at Goldman Sachs. Welcome to our third quarter earnings conference call.

Today's call may include forward-looking statements. These statements represent the firm's belief regarding future events that by their nature are uncertain and outside of the firm's control. The firm's actual results and financial condition may differ, possibly materially, from what is indicated in those forward-looking statements. For discussion of some of the risks and factors that could affect the firm's future results, please see the description of risk factors in our current annual report on Form 10-K for our year ended December 2012.

I would also direct you to read the forward-looking disclaimers in our quarterly earnings release, particularly as it relates to our Investment Banking transaction backlog, capital ratios, risk-weighted assets, and Global Core Excess. And you should also read the information on the calculation of non-GAAP financial measures and regulatory capital ratios that are posted on the Investor Relations portion of our website at www.gs.com.

Our chief financial officer, Harvey Schwartz, will now review the firm's results. Harvey?

Harvey Schwartz

Thanks, Dane, and thanks to everyone for dialing in today. I'll walk you through our third quarter results, and then take your questions. Net revenues for the quarter were $6.7 billion, net earnings, $1.5 billion, earnings per diluted share, $2.88, and our year to date annualized return on common equity was 10.4%.

While there were some headwinds in the third quarter, our year to date performance remained solid, in what continues to be a challenging macro-environment. On last quarter's call, we talked about how market participants were trying to assess the outlook for the global economy, specifically whether a recovering U.S. economy could potentially offset slower growth in other economic regions.

In addition, the shifting commentary on monetary policy was leading our clients to question the potential economic and market impacts of reduced quantitative easing. These discussions continued in the third quarter. Ongoing uncertainty around the economic outlook and the traditional seasonal slowdown drove a significant reduction in client activity during the quarter.

This reduction in nationwide client activity obviously impacted the opportunity set in many of our businesses. In investment banking, equity and equity related volumes declined 27% quarter over quarter. Debt [unintelligible] volumes declined 10% versus the prior quarter, and completed M&A volumes declined 36% sequentially.

Within our institutional client services businesses, most product areas also experienced reduced levels of client activity. For example, within credit products, investment grade and high-yield volumes declined sequentially by 13% and 19% respectively when looking at trades data. In U.S. equity markets, stock buy-ins were down 13% to an average daily volume of 5.8 billion shares.

However, activity improved in September with our investment banking clients. Announced M&A volumes increased significantly, and overall backlog improved to its highest level in five years. During the quarter, we also saw continued positive trends within our investment management business. Assets under supervision reached a record level, aided by $17 billion of net inflows.

I'll now run through each of our businesses. Investment banking produced third quarter net revenues of $1.2 billion, down 25% from the second quarter. Third quarter advisory revenues were $423 million, down 13% from the second quarter, reflecting a decline in industry-wide completed M&A transactions.

Year to date, Goldman Sachs ranked first in worldwide announced and completed M&A. We advise on a number of important transactions that closed in the third quarter, including Softbank's $21.6 billion purchase of a majority stake in Sprint, Bausch & Lomb's $8.7 billion sale to Valeant, and Apache's $3.75 billion sale of selected assets to Fieldwood Energy.

We're also an advisor on a number of significant announced transactions. They include Vodafone's U.S. $130 billion disposal of its U.S. group, whose principal asset is its 45% interest in Verizon Wireless; Applied Materials' merger with Tokyo Electron for a combined value of $29 billion; and Grohe's $3.9 billion sale of a majority stake to Lixil.

Third quarter net revenues were $743 million, down 30% from a strong second quarter. Equity underwriting revenues of $276 million were down 26% compared with the second quarter, driven by a decline in industry-wide activity. Year to date, Goldman Sachs ranked first in global equity and equity-related common stock offerings and IPOs.

Switching over to debt, underwriting revenues were $467 million, and represented a 33% decline relative to a record second quarter. During the third quarter, there were several noteworthy transactions: BHP Billiton's $5 billion debt offering, Schaeffler's $1.3 billion sale of a portion of its equity stake in Continental , and ADT's $1 billion high-yield offering.

Let me now turn to institutional client services. Total net revenues were $2.9 billion in the third quarter. Fixed client execution net revenues were $1.2 billion in the third quarter, substantially lower than the second quarter, clearly not a good quarter for FIC. The significant decline in revenues was driven in part by seasonally slower activity levels seen across the industry and a more challenging macro-environment.

While rates were up relative to a weak second quarter, activity levels remained muted. Revenues within currencies decreased significantly relative to the second quarter, on difficulty managing inventory and reduced activity levels.

Commodities decreased significantly versus the second quarter under challenging market making conditions and also lower client activity levels. Revenues within credit decreased significantly on lower volumes. Mortgage results decreased sequentially as clients became more risk averse given the potential for tapering in the U.S.

Turning to equities, net revenues for the third quarter were $1.6 billion, down 13% from the second quarter. Equities client execution revenues were $549 million, down 14% sequentially. If you adjust for the sale of our Americas reinsurance business in the second quarter, revenues essentially flat.

Commissions and fees were $727 million, down 13% from the second quarter, again reflecting lower market volumes. Security services net revenues of $340 million declined 10% from the seasonally stronger second quarter.

With respect to risk, average daily volume in the third quarter was $84 million, up 4% from second quarter levels.

Let me now review investing and lending. We produced net revenues of $1.5 billion in the third quarter. Investing and lending includes direct investing, investing we do through funds, as well as lending activities.

These activities occur across a diversified set of asset classes, including both equity and debt. Equity securities generated net revenues of $938 million, primarily reflecting gains from private equity investments.

This increase in fair value was driven by company-specific events like IPOs, strong corporate performance, and higher equity prices. Net revenues from debt securities and loans were $300 million, primarily from interest income. Other revenues of $237 million include the firm's consolidated investment entities.

Switching to investment management, we reported third quarter net revenues of $1.2 billion. Management and other fees were $1.1 billion, 1% lower sequentially. During the third quarter, assets under supervision increased $36 billion to a record $991 billion. Net market appreciation of $19 billion was primarily in equity assets, while $17 billion in inflows were concentrated in fixed income assets.

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

This is 200 basis points lower than the firm's accrual in the first half of the year. The lower compensation accrual reflects year-to-date revenues and better visibility on expected compensation levels as we approach the end of the year.

Third quarter non-compensation expenses were $2.2 billion, 4% lower than the second quarter, largely due to the sale of our reinsurance business and lower brokerage, clearing, and execution costs.

Year to date, our effective tax rate was 30.3%.

On capital, we repurchased 10.2 million shares of common stock for a total cost of $1.65 billion during the quarter. Year to date, we have repurchased 30.8 million shares for a total cost of $4.77 billion. Today, we also announced an increase in our quarterly common stock dividend from $0.50 to $0.55 per share.

Moving on to regulatory capital ratios, our Basel III tier one common ratio on a fully loaded basis is 9.8%, up 50 basis points from the second quarter, driven by a reduction in risk. The risk-weighted assets are approximately

$590 billion, $345 billion in credit risk, $165 billion in market risk, and about $80 billion in operational risk.

Our estimate for the proposed supplementary leverage ratio under U.S. rules is approximately 5% for the firm and approximately 6% for the bank. This is our best estimate, subject to change, depending on regulatory clarifications.

Like all other proposed regulatory requirements, we will work closely with our regulators as we evaluate and finalize the proposal. We believe it is our obligation to support safety and soundness within the financial services industry and the global financial system. As it relates to how we'll run the business, similar to other regulatory metrics, the supplementary leverage ratio will be an important input.

Clearly, concerns about the global economic outlook created a more difficult operating environment for our clients in the third quarter. These challenges were amplified by the seasonal slowdown traditionally impacting client activity in July and August.

However, we don't build client relationships or build businesses for a quarter. Client relationships and operating businesses require years, often decades, of investment to build the durability that ultimately creates long-term shareholder value.

Across the globe, our investment banking clients seek our advice on their most important strategic decisions. Corporate, government, and institutional asset management clients look to our execution and risk management capabilities across a variety of products and regions. We are entrusted to provide investment management services and offer investment products across all major asset classes through a diverse set of institutional and individual clients, making us one of the largest asset managers in the world.

Our clients often value our advice and services the most when the outlook is less certain, and when finding solutions becomes more challenging. The U.S. government shutdown and the debate in the United States surrounding the government debt ceiling has become a concern for our clients.

The political complexity involved in finding a long-term solution has created uncertainty about the world's economic outlook, and as we have all seen, has weighed heavily on market sentiment. Now that the political impasse looks to be resolved for the near term, we're hopeful that greater certainty will drive improved client confidence and activity levels. Having said that, a long term solution is critical to the sustained recovery for the economy.

These fluctuations have not distracted us from focusing on the long term drivers of our business, so as a management team, we are focused first and foremost on our clients, building deep, meaningful relationships and providing solutions to their daily challenges. We are focused on conservatively managing our financial profile and being prudent allocators of capital. We are also focused on being efficient operators, while at the same time providing world-class service to our clients

In the end, we are focused on creating long term shareholder value for you, our shareholders.

With that, I'd like to thank you again for listening today, and I'm happy now to take your questions.

Question-and-Answer Session

Operator

[Operator instructions.] Your first question is from the line of Howard Chen with Crédit Suisse.

Howard Chen - Crédit Suisse

I was hoping to come back to your commentary on FIC. Understanding all of your peers' business mix is different, but the relative revenue performance this quarter is pretty wide. So I was just hoping you could add a bit more color on how you would attribute that gap to your relative business mix, the positioning issues you noted, and maybe just more challenging comparables.

Harvey Schwartz

As I said a few minutes ago, clearly a difficult environment for FIC, and we're not happy with the results. So having said that, with respect to business mix, I think there could be something there in terms of how different franchises are positioned. Certainly as we've discussed with you in the past, our FIC business may be somewhat more weighted towards institutional asset managers.

If I back up for a second, if you remember on last quarter's call, somebody asked me a question about how I thought the market would respond to the potential changes in monetary policy, and the discussion really is around how data-centric people would be. And of course we came into the summer with less certainly around monetary policy, and then there were events in the Middle East, and then of course people actually couldn't get data with the government shutdown.

So I think there could be something in that. So, I think the whole market environment is not good for that particular client base. However, I don't want to sound defensive. Again, just not a good quarter for us in FIC.

Howard Chen - Crédit Suisse

And then you specifically mentioned foreign exchange in your commentary. Can you talk a bit more on what exactly happened in the quarter in that business, and are you able to size the potential facilitation issue and the impact it had on the quarter?

Harvey Schwartz

In terms of the currency business, obviously it was a business I highlighted, where it was challenging market making conditions and certainly from an inventory perspective. You know, we look at various metrics.

I mean one metric I could point to, for example, would be the VAR schedule in the earnings release. And as you can see, basically from the first quarter to the second quarter, there was a lot of activity in the franchise, and risk had picked up in foreign exchange, and then you'll see quarter over quarter it's a pretty significant drop in the currency line. And that's virtually all driven by risk reduction.

In terms of the franchise itself, this I will say, we look at a variety of metrics like you would think, all the numbers we can. We look at our own internal numbers, sales activity, where we can get transparency into the market. But there's nothing in that data that would tell us that when we look at the metrics, client engagement looks consistent with those kind of volumes. So, franchise feels good. We just had a tough quarter.

Howard Chen - Crédit Suisse

And then shifting gears to the comp accrual, it's pretty unusual to see the firm change the accrual in the third quarter. So, I was just hoping to better understand what's different this year. Is the message that in this still challenged backdrop, your desire is to not fall below a certain return threshold?

Harvey Schwartz

Well, as always, the comp accrual is based on our best estimate for where we think we'll end up for the end of the year, but of course we still have a quarter to go. I think as it relates to compensation expense, as we've talked about before, it's obviously the firm's largest expense, and so this process, no different. This I want to be clear with everyone. No difference in terms of philosophy in the way we're approaching compensation.

So it's still all the same things we go through in terms of the pay for performance culture that we drive, and so we'll look at all the components, competitive dynamic, performance, as I mentioned. And of course shareholders and ROE and the way we incorporate that in our thinking, that's always of course an important meaningful component of it.

Howard Chen - Crédit Suisse

And finally, with a few more months since the initial proposals have been out, I was hoping you could just update us on your thoughts on supplemental leverage ratio, where the firm may sit today and potential mitigating actions.

Harvey Schwartz

As I said before, under the U.S. rules, which are proposed, we're at 5% for the hold co and 6% for the bank. We had time obviously in the quarter to analyze the proposed rule. And again, I caveat this that it's a proposed rule, will likely change. And of course, it's not effective until 2018.

But I think you should assume that that's a somewhat conservative estimate, the 5% and the 6%, and in terms of mitigating actions, too early for us to really be thinking heavily about mitigating actions. We want to see how the rule evolves. We'll engage the regulators.

And the way we incorporate this, for a lack of better language, it will be how we incorporate this into our toolkit will be no different than we do with other regulatory metrics. Just like we talked about at your conference earlier in the year, which is actually rolling out some sample tools has proved to be fortuitous in terms of giving people an example of how we'll deploy it. But it's pretty early in the process. We'll see how it evolves.

Operator

Your next question is from the line of Glenn Schorr with ISI. Please go ahead.

Glenn Schorr - ISI

Maybe we could talk about I&L for a second. I wonder if you could provide any update on capital and RWA in I&L, not sure if you feel like breaking out equity versus MES. But I'm thinking down the process of, is there a natural annual runoff rate or realization rate in I&L, and if all that capital generation that you have, if you're finding opportunities to reinvest it back in?

Harvey Schwartz

Really excellent question. We haven't broken down and disclosed the allocation by those segments in terms of the capital. And I think it's clear if we think about the capital allocation in terms of sort of the conventional market credit, etc. In terms of the way we're managing the capital deployment, as you've seen, we've been in somewhat of a harvesting mode, because that's what the market opportunity has provided. As we've talked about before, we've stayed very disciplined in terms of return characteristics.

As it relates to capital itself, as you know, the investments in funds are deductions from capital under the Basel III ratios. Now, there are transitional provisions, so for example under the transitional provisions, our Basel III capital ratio would be about 100 basis points higher than the 9.8, but I've been quoting you the fully loaded. That is the way I would think about it.

Glenn Schorr - ISI

So from that standpoint, given that the market's providing you harvest opportunities, but not the same level of investing opportunities, there is a natural runoff. I don't want to put words in your mouth, but the production of the business unit or line item in general has been great, but there should be some natural shrinkage until there's a reinvestment mode. Is that not a right way to think about it?

Harvey Schwartz

I would think about it no differently than we've approached it in the past, which is there will be cycles when reinvestment opportunities for us and our clients seem more attractive, and there will be parts of the cycle where harvesting is more attractive. We happen to be slightly more in a harvesting cycle. But recently, actually, we've seen some good investment opportunities. They tend to be a bit more geographically based, given some of the geographic differences and stress around the world. But that's no different in terms of philosophy and I think the way to think about how we operate the business.

Glenn Schorr - ISI

Just shifting gears for a second, you just alluded to Howard's question a little bit, but just curious, the biggest users of gross balance sheet within FIC, and you guys were early and pushing down Basel III requirements out on to the desk. Is it way early on leverage? I'm just curious on how the leverage focus even is going to start impacting yours and others' balance sheets.

Harvey Schwartz

Again, too early to tell in terms of how we'll incorporate it as an operating metric. But at this stage, based on what we know - again, I want to be really careful about the caveats here, because this is an evolving rule - a couple of things. One, based on what we know about the rule, something that we'll be able to incorporate again into this toolkit. And separately, remember again, of course, it's effective in 2018. So in terms of capital planning, given we're at 5% and 6%, again under the proposal, it could change. Right now, I see it as something that we'll digest into our processes no differently than other rules have.

Glenn Schorr - ISI

Last quickie, the Basel III numbers you gave, is that standardized or advanced? What's the spread between the two?

Harvey Schwartz

That's a good question. So, Basel III, again, fully loaded, was 9.8. Standardized is approximately 9.1. So lower than obviously the advanced. And again, referring to the transitional provisions, I'm giving you fully loaded, as though we're standing many years out into the future. They're both about 100 basis points higher with the provisions.

Glenn Schorr - ISI

And just target-wise, we should be thinking of the 7 plus the 2.5, plus a little buffer?

Harvey Schwartz

Yeah, you know, we'd announced a buffer of 100 basis points and targeting around 9.5. We're now living with the metric. We're not too wedded to that particular number. I think the way I would describe it strategically is we want to run with enough capital first and foremost to position the firm defensively. We want to be in an exceptionally strong capital position.

But also obviously the flipside of that is we really always want to be in a position so we can make capital to our clients. And it's been an environment, for the last couple of years, which has been trending better, but I wouldn't call it a first-quartile client opportunity set. And so we're moving across. And to be clear, it's 1.5, not 2.5.

Operator

Your next question is from the line of Roger Freeman with Barclays. Please go ahead.

Roger Freeman - Barclays

So I guess coming back to the FICC business, just broadly speaking, and you talk about client activity, client volumes, positioning, and then there's also sort of the factor of market liquidity, which ties across it too, but your ability to sort of trade around positions. If you kind of think about the impacts broadly on the third quarter, where would you sort of rate those three things? Just trying to think about the balance of the impacts.

Harvey Schwartz

Well, as I said before, I think from a client activity perspective, when we look at all those metrics, all that looks quite positive. So I don't think that was an impact at all. Liquidity is always a factor in markets, where you're in the summer, there's a fair bit of uncertainty. I wouldn't overweight it. Again, the shift from the second quarter to the third quarter, we just didn't execute as well as we would have liked to.

Roger Freeman - Barclays

And what's your sense of how the market environment going forward here, with a whole evening to digest the deal in Washington last night, punting to January, do you think this is a headwind for client risk taking? Or a relief? Or what?

Harvey Schwartz

Well, certainly a relief. We'll see how people digest what the events look like coming into the first quarter. But certainly to the extent to which our clients, which are evaluating transactions, whether it's mergers, debt-equity activity, institutional clients…

You know, one good thing about the crisis is it's made everybody focus on [tail] risk. And even though, as we came into the debt ceiling negotiations, while I think you could have argued maybe the tail risk was maybe quite low, the world and all of our clients are very respective of tail risk. It's much easier to do nothing than it is to do something. S o in the short term, got to think having this removed from the marketplace is quite good. The longer term solutions, sort of the continued path back to normalcy, if you will, which I think we've been marching along pretty steadily, but it's been kind of a two or three steps forward, one step back, I think getting to a point where we're just in a comfortable stride as a global economy, the long term's quite important, obviously.

Roger Freeman - Barclays

And then on I&L, coming back to Glenn's question, if you think about a future investing cycle, and factoring in the deductions to capital under the new framework, what do you think, and it might be too hard to answer here, but what kind of return hurdles would make that worthwhile? And do you think private equity, like investments, where those firms target 20% plus returns, with that kind of an outlook, is that still viable with the capital holdbacks on this?

Harvey Schwartz

There have always been very high requirements to utilize the balance sheet for multiyear capital commitments. And those would be more than enough to be beyond the [unintelligible] of specific capital requirements. So that's not a concern. So that's a factor that I'm not worried about. As I said, what we're really seeing is more of the cyclical back and forth.

But you know, in some respects, and we've talked about this before, you either get good new investing opportunities or you get the opportunity to deploy the capital into other businesses, or you can return the capital.

Roger Freeman - Barclays

On commodities, what does it take, in your mind, to get that business getting, I guess, back to some sort of normalcy? It's just been challenging for you and others. Can this work inside of a broker-dealer with the capital [unintelligible] rules still to be determined?

Harvey Schwartz

I would maybe add to your question a little bit. So, the commodity environment has been a little bit difficult. Low volatility and obviously impacted by the macro backdrop. But just to specifically get to your question, the commodity business for us, as you know, we've been in the business for 30-plus years. It's been a central business for our clients.

The nature of the activity is we're on the phone with CEOs, CFOs, treasurers. The nature of the business itself, in terms of their objectives, is no different than it would be, for example, for a retailer. It's about hedging, it's about managing revenue, it's about financing activities, timing of cash flows. For example, it's very akin to receivables financing for a retailer, or managing their expense base for a consumer of commodities.

Those are all normal corporate treasury functions that we perform now with clients for 30 years. And we'll see what happens in the regulatory discussion. It's an important discussion, but it's not distracting us from the focus on our clients.

Operator

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

Michael Carrier - Bank of America Merrill Lynch

You had a comment that in September you saw a pickup on the investment banking side, and we can clearly see that. I guess just anything on maybe the FICC side, just given the environment in the third quarter, versus what you're seeing now. There's still some obviously macro uncertainty, but just any color. I know you guys don't tend to give too much color in terms of the current quarter, and it's only a short period of time, but any trends that have been different September and October?

Harvey Schwartz

Again, you had the July and August normal seasonal slowdown, and then of course you had a pickup in September. But activity from the client base was picking up pretty much really broadly in the early part of September, but then of course people got very focused on the government debate.

So there really wasn't a chance for people to shift into what I'll call a mode where they had more conviction. It was still an environment of uncertainty. But I guess if I had to really sort of slice it for you, I'd say certainly there was a seasonal pickup after August, with kind of this backdrop of uncertainty, which fortunately, at least for a while, is behind us this morning.

Michael Carrier - Bank of America Merrill Lynch

And then maybe as we head into next year, and you look at the FICC business, it seems like we've kind of gone through this clearing portion in the OTC markets with no big issues. It's run relatively smoothly. The SEF, it seems like it's a bigger implementation project for the entire industry.

If we start looking at February as an important timeline, based on the different scenarios that can play out, meaning they work, they partially work, it's a complete mess, how do you think it impacts the FICC business heading into 2014 and beyond, and particularly heading into that? Are clients still going to be transacting? Do you think volumes are a bit weak? Just any color on that.

Harvey Schwartz

We were, as you know, big supporters of clearing. And I'll give the market and the regulators really high marks on our clients. A huge amount of work went in by all participants, as you noted, to get clearing off. It was really uneventful, as it should have been, and I think the three stages of client introduction to clearing were quite thoughtful.

As you pointed out, with kind of the launch of SEF, it was harder. There's a lot of infrastructure, and it's complicated for clients, various rule sets. And so it's going to take a lot of work, from everyone in the industry, regulators, SEF operators, market participants like Goldman Sachs, all of our clients, who have a deep, vested interest in getting this right, to be active in that dialog between now and the spring to really work out all of the issues.

I don't think you can read too much into the October launch of Swap Execution Facilities other than there's a lot of work to do. And I think the regulators were quite thoughtful in pushing out some of the decisions to November 1. Then of course we had the government shutdown, so they haven't been there to focus on it. But we're going to all have to pay a lot of attention to this. I don't think we can, as market participants - and when I say "we" I don't mean Goldman Sachs, I mean all of us - we can't afford to have a total mess.

I don't think that's an option that we should all accept. If it takes longer to get it in place, just like it took longer to get clearing in place, that's what we should do. It's just too important for our clients and for the industry. So it will be a big focus over the next couple of months. But there is a lot of work to do.

Michael Carrier - Bank of America Merrill Lynch

And then just finally, you guys haven't said any new, like, ROE or return on tangible equity targets. Obviously there's still a lot of uncertainty in terms of the rules. When you do look at it in terms of what management, the board wants to generate in terms of return that makes sense, and you've been maneuvering, whether it's on the revenue side, the expense side, comp this quarter, what is still an adequate return between now and when we get clarity? Because obviously once we get clarity then you can make more strategic moves. But just trying to understand, it's been a fairly long time horizon in terms of we haven't gotten the rules, and so in this interim, before you can kind of set out that new cross-cycle target, something in the interim?

Harvey Schwartz

With respect to returns, this is what I would say. Strategically, the way we're managing the firm is, as we've talked about, it's for the long run. So it's for the long run positioning. Now, having said that, we're very sensitive to components of the cycle. And as you point out, this has been a slightly longer cycle.

So the simplified Cliff's Notes version of strategy for the firm over the past several years has been 1) extreme focus on the clients globally, 2) to make sure that while maintaining that focus that we're also managing the cost base, which is why a couple of years ago we announced the multiple series of cost reductions which brought it down roughly $2 billion, and then, along with that, a whole host of efficiency efforts. That's all been designed to create operating leverage.

And so we feel like we're really really well-positioned from an operating leverage perspective. We just need to move back to a market environment that, as I said earlier, is not two or three steps forward, one step back, because that's really what our clients will need to feel a sense of conviction. And then you get back to more of a run rate.

Now, the rule uncertainty is still pretty significant. And as we digest the rules, we'll certainly be evaluating them in the context of an overall ROE target. What I would say, because I don't want you to get off the call without this message, things that are going to be on the balance sheets for multiple years, we are still just as disappointed as we always have been. There's no change to those return hurdles. And we're exquisitely focused on that.

Operator

Your next question is from the line of Matt O'Connor with Deutsche Bank. Please go ahead.

Matt O'Connor - Deutsche Bank

If I could just drill into the equity trading business a little bit. I guess if we ex the reinsurance and DVA both periods it seems like it's down about 10% year over year. And I realize the base is always tricky, but the three universal banks that have reported so far have been showing up anywhere from 20% to 35%. So any additional color there would be helpful.

Harvey Schwartz

There's ins and outs, as you pointed out, year over year. Last year, of course, we facilitated the Knight transaction, which was obviously a component of revenues last year. And so there's back and forth, sort of ins and outs. I think when you sum it all up, really what you do is you get to a number that's more flat.

Matt O'Connor - Deutsche Bank

And then just on the expense side, as we think about noncomp costs and litigation, just thoughts on those two going forward?

Harvey Schwartz

On noncomp, as I said, a big part of the strategy, particularly in this environment, which is very news sensitive from a client activity level, we're staying very vigilant on noncomp. And just as we have in the past, you obviously would have seen in the earnings release we accrued $142 million for litigation reserve this quarter, $149 million last quarter. We're evaluating all the normal inputs we would with respect to litigation expense and reserving it quarterly.

Matt O'Connor - Deutsche Bank

And just lastly, on the comp, and I think you had said this in the prepared remarks, but making some of the adjustments that you normally do in Q4 this quarter, should we think about kind of a more straight line approach in Q4? So if we look at the year to date comp level, about 41%, is that a good starting point as we think about a fourth quarter?

Harvey Schwartz

We'll get to compensation in the fourth quarter when we get to it. I more or less went through all the components of how we thought about compensation philosophically, which is no change. So it's our best estimate, but it also reflects the fact that on a year to date revenue basis, we're running $500 million ahead.

Operator

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

Betsy Graseck - Morgan Stanley

A couple of questions. One is just on the comp ratio. I know you talked about it a little bit earlier, but in the past, I know you've paid on all revenues. Is that still the same approach you are taking? I just wanted to clarify that, because as was mentioned earlier, the ratio coming down in the third quarter is a little unusual.

Harvey Schwartz

Yeah, no, I think it's our lowest accrual for nine months. But it reflects, as it always has, the collection of businesses across the firm. And I won't bore everybody with all the other components in terms of our processes, but again, it's our best estimate.

Betsy Graseck - Morgan Stanley

And then on the FICC, just a little bit of a cleanup question. You indicated the challenging macro-environment obviously. I'm just thinking, from a competitive positioning standpoint, obviously underwriting can tend to be important as to how you are able to generate trading revenues over the course of the quarter. And do you feel like there was any reason that you might have been behind competitors, because you weren't involved in all of the high-profile deals that were out this quarter?

Harvey Schwartz

There are certain large transactions, obviously, where we were on one side of a transaction versus others. But that's going to be in the normal mix of business. And so some quarters we'll be a big, dominant participant, and other quarters [unintelligible]. But over the cycle, as you know, you'll see us be involved in most of the significant transactions.

Betsy Graseck - Morgan Stanley

And then the other question has to do with the SLR. You've talked a lot about the [unintelligible] and the Basel common tier one ratio, so I got that. So I'm just wondering, on the SLR side, is that also fully loaded?

Harvey Schwartz

Well, yes, you should think of it as fully loaded.

Betsy Graseck - Morgan Stanley

And I know there's a couple of different ways that you can calculate derivatives. Which way are you guys choosing to do that right now?

Harvey Schwartz

We're just following the rules as we understand them. There's no difference in terms of different alternatives. But we're happy to discuss it with you more offline.

Betsy Graseck - Morgan Stanley

Okay. No, I'm just wondering about the CEM approach, or not. I wasn't sure which one you're choosing.

Harvey Schwartz

Sorry, the CEM approach. Earnings [unintelligible] methodology, for anyone on the call who's not familiar with the shorthand.

Operator

Your next question is from the line of Chris Kotowski with Oppenheimer & Company. Please go ahead.

Chris Kotowski - Oppenheimer & Company

There's been a lot in the press about how the regulators and the government officials want banks to divest their physical commodities business. There was another article in the Journal this morning. And I wonder if you can talk a little bit about A) how critical is the physical commodities business to the whole of your commodities business and B) if, hypothetically, there were a sale or divestiture of the physical business, does that free up capital above and beyond whatever proceeds you would realize, meaning does the physical commodity business come with meaningful RWAs or other operational risks or charges or things like that?

Harvey Schwartz

So we haven't disclosed any specifics around risk-weighted assets or capital associated with physical commodities. The business for us, overly simplified, really splits into two parts. One, there's investments that we own. And then there's the franchise, which I talked a bit more about in an earlier question.

As it relates to investments that we own, they're on a normal lifecycle where we would intend to hold them for years. As it relates to the commodities franchise, the extent to which we're involved in the physical business is the extent to which our clients need us to be involved in the physical business because in commodities, which is a bit different from other businesses, obviously, they need to, many times, receive delivery. And so we could be arranged in that.

Very often, though, under those types of transactions, we are not the holder of title, or may be the holder of title. But it's important from the standpoint of being able to fulfill those earlier requirements that clients have, hedging, financing, etc. But that's how I would, very high level, split out the way the physical aspect of our business is part of our strategy, if you will.

Chris Kotowski - Oppenheimer & Company

Okay, so it's important to you?

Harvey Schwartz

Well, it's important to our clients, so by extension it's important to us. Now, we have a long, long investment in the commodity business, and we have, at this stage, no intention of selling our business. We're very committed to our clients here. And so we'll just work with the regulators. But ultimately the regulators will come to their own opinion about the business.

Operator

Your next question is from the line of Mike Mayo with CLSA. Please go ahead.

Mike Mayo - CLSA

Can you size the investment banking backlog? You said it's the largest in five years.

Harvey Schwartz

No, we don't size it, but it's a pretty significant move up, as I said. I'll give you a little bit of color. It's more significant in equity underwriting and in the advisory side of the business.

Mike Mayo - CLSA

And then back to FICC, we've heard a lot of reasons why FICC was weak, and you said you're not happy with it. And I'm still trying to get my arms around it. You said it's activity, it's seasonal, it's Washington, DC, it's macro. You said for currencies it's lower VAR and inventory, commodities market making. Credit, it's volumes. Mortgage, it's tapering. So let me just ask a real simple question. Do you think the decline in FICC that you're not happy with is a one-quarter blip, or that some of those factors should continue?

Harvey Schwartz

It's just a quarter, Mike. And those factors, obviously, the marketplace has to do with a lot of those factors too, which is why I say we're not happy with it. But it's a quarter. We have a very strong FICC franchise, and that's why I highlighted earlier we react to these things and we're very data-focused, but when we look into, for example, all the indicators of client activity, it's just a quarter.

Mike Mayo - CLSA

Well, a follow up to that. Is any of the decline related to how you're managing the business differently, whether it's the balance sheet - I know the rules don't take effect until 2018, but you can take actions now - or the business, due to some regulatory changes, which you've talked about, or even how you empower the traders to manage around risk-weighted assets more?

Harvey Schwartz

No, not that we can see. For example, look at the second quarter and the first quarter. There was no rule implementation or change in management in terms of the way we think about ratios or the proposed supplementary leverage ratio that would have affected the way we run the business - and this is a really important strategic takeaway - on July 1, and the way we'd run it on June 30. Just not a great quarter.

Mike Mayo - CLSA

I know you haven't disclosed this before, but can you give us some detail on FICC, what are the revenues for currencies, commodities, credit, and mortgage, from the second to the third quarter?

Harvey Schwartz

Not beyond what I covered in my opening comments. I highlighted currencies. I think it's a good example of where we had some challenges. You know, look, year over year I think we have a bigger mortgage business than some other folks, and so you'll recall last year we were coming into the environment of QE, and so appetite from clients was significantly greater in mortgages. But I more or less covered it in my prepared remarks.

Operator

Your next question is from the line of Matt Burnell with Wells Fargo. Please go ahead.

Matt Burnell - Wells Fargo Securities

Just wanted to focus a little bit on the inflows you talked about in assets under management, specifically in the $12 billion in fixed income. Can you provide a little more color on what those assets were and sort of your thinking about how that trajectory could continue into the fourth quarter?

Harvey Schwartz

In terms of those assets, this is a bit of just the result of our strategy, and I want to sound old-fashioned on this, because there's nothing new here. This is just continued focus on performance. And the fixed income team has done a good job in performance. In terms of flows and broadly speaking where they came from, the flows were diversified. Institutional also from our private wealth franchise, which has had a long, long record now, multiquarter record, of inflows. But really it's kind of old-fashioned. Nothing new, just performance.

Matt Burnell - Wells Fargo Securities

And are the flows generally focused in lower yielding fixed income assets, or slightly higher yielding fixed income assets?

Harvey Schwartz

It's a mix. But quite frankly I don't have that detail with me. I'd be happy to have Dane and Heather follow up with you afterwards. But my recollection is it's a mix.

Matt Burnell - Wells Fargo Securities

And then just secondarily, the quarter end balances for the GCE were down a little bit, and granted maybe I'm making too much of this, but I guess I'm just curious as to why those were down, as you ended the quarter, given that we've heard from a number of clients that they were increasing their liquidity as a result of some of the macro issues in DC.

Harvey Schwartz

If you look at the last two quarters, you'll see second quarter I think we averaged 180, and then we finished at 183, so there was liquidity building up towards the end of the quarter. In a quiet market environment, you'll see us generally - not always, of course, but generally - build liquidity. And so you'll see that the average for the quarter was even higher than the endpoint of June. The average was 187. There were just individual one-off things that utilized liquidity at the end of the quarter as part of our franchise.

Matt Burnell - Wells Fargo Securities

And just finally, you talked about this a little bit in terms of the commodity VAR, but overall with the VAR being about $84 million for the quarter, up a little bit quarter over quarter, I guess I'm just curious if the change quarter over quarter was as much due to market volatility, or is that just your positioning within the individual risk categories?

Harvey Schwartz

It was more due to volatility over the quarter. If you look, for example, in currencies, the decline was, as I mentioned earlier, more related to positions. Same with most of the other businesses. Rates was a little bit the other way, but not much.

Operator

Your next question is from the line of Kian Abouhossein with JPMorgan. Please go ahead.

Kian Abouhossein - JPMorgan

Starting with leverage, I'm more interested in the Basel III proposal leverage, and I was wondering if you could give us also some indication how your leverage ratio would look like under the Basel III proposal which came out recently.

Harvey Schwartz

It's just a proposal, so we're in the proposal phase on that.

Kian Abouhossein - JPMorgan

What are the issues that you see as nonworkable or, let's put it differently, in terms of concerns within the Basel III proposal relative to what you see from the U.S. proposal?

Harvey Schwartz

I wouldn't want to draw a lot of distinctions between the two proposals. There are certain things that the industry broadly, and obviously you can check, we submitted a letter. I would say collateral for one, the treatment of collateral. I think at the highest level, we like metrics, and I think a leverage ratio can play a valuable role in a suite of metrics. I just think, like all metrics collectively, whether it's the U.S. rule or the Basel III proposal, I think we all, as market participants, always need to be focused on any unintended consequences.

So the things that we're most focused on are things like liquidity pools and how they're incorporated into metrics. Because we just generally don't think people should be incented to hold liquidity at the regulatory minimums. And that might not happen tomorrow, but these rules will be in place for a very, very long time, and so we need to incorporate them that way. But as I said, collateral will be one thing that we would be focused on on the Basel III.

Kian Abouhossein - JPMorgan

And credit derivative notional hedging, is that something where you feel quite comfortable with the Basel III guidelines and the proposal that you could meet a lot of [netting], or do you think that's something that you would have to change the way you hedge your positions in order to justify the netting under the proposal.

Harvey Schwartz

It's very early to be thinking about responding to these. So, again, let's start high-level. So, getting gross notional down, it's a good thing. It's clean living. Gross notionals certainly can create risk, but not risk in the sense of the way that we think about market risk, and I'm not talking about the market risk in an RWA sense. I'm talking about risk in the marketplace.

I think that the focus on gross notionals is an important one, but I think, again, this is difficult, but I think what you would see the industry do is get very focused on collapsing gross notionals. To date, when the industry comes together to focus on gross notionals, obviously everyone's focused on the economics. I think you could see people be more open to the economic cost of shrinking gross notionals. But all this is included in our letter.

Kian Abouhossein - JPMorgan

Moving towards the results, just I wanted to come back to FICC. If I look at the percentage decline that some of your peers have shown so far in this quarter, and as I even make an adjustment additionally considering you may be slightly more impacted due to your being more over credit [unintelligible], I calculate that the potential inventory FX impact could be around $500 million in terms of impacting your results. I'm just trying to understand the material decline here in your FICC results, and I'm just wondering if there's something that I'm doing incorrectly, looking at it from this perspective of looking at [peer seasonality] giving you slightly more of a decline due to your mix, and then assuming the rest is FX inventory related.

Harvey Schwartz

I think it's a little complicated to compare, in an individual quarter, if we're down a certain percentage and our competitors are down a certain perspective and really take a lot of information away from that. Now, obviously it's important, but I think trying to draw conclusions on the math is harder, so I don't know that I can give you any more information as we talked about. I think to sum it up we had a tougher quarter. By the way, we will have quarters where we will have outperformance, and we will have tough quarters. This will be a tough one.

Kian Abouhossein - JPMorgan

But why would you have FX inventory in the first place, a very liquid market. I understand you run your FX with your EM business together. Just trying to understand what are the positions that would hold inventory on behalf of clients.

Harvey Schwartz

As you would perfectly understand, I'm not going to get into the details about specific positions. But as I said, you can see it in the VAR profile, the derisking, but I can't give you any more color than that.

Kian Abouhossein - JPMorgan

Last question on this, then. Are the positions that you had in the inventory actually sold, or are they hedged?

Harvey Schwartz

I think you're misunderstanding my message at this point. There are no core positions that are something that are a significant concern. It sounded like that's what you're asking. I won't talk about how we manage the risk.

Kian Abouhossein - JPMorgan

Yes, that's what I'm more interested in, if you still have some notional on the books, or you actually sold the notional.

Harvey Schwartz

No, I didn't answer the question, actually.

Operator

Your next question is from the line of Douglas Sipkin with Susquehanna. Please go ahead.

Douglas Sipkin - Susquehanna Financial Group

I just wanted to follow up a little bit, drilling down on the [iBank] pipeline. Just given the commentary around the trading environment and uncertainty, I'm just trying to reconcile that with the five-year record pipeline, which would require CEO confidence to do things with M&A and equity. So maybe you can sort of relate the two back. While it's great, it just seems like it's abnormally high for the environment that we're in to have such a high pipeline. What exactly are you guys seeing? What's happening that it's so big, given the uncertain environment that we're in?

Harvey Schwartz

It's a great question. As you know, the dialog around M&A activity and financing activity, but M&A activity in particular, it's a very very long lifecycle dialog. And if we had one of our merger bankers in the room, very often, in a particular transaction, not just a client, but the particular transaction could be under discussion for multiple years. In an environment with very high uncertainty, which is a low-conviction environment, obviously, then transactions tend to get delayed.

So it's not one of these things that turns on or off like a light switch. So nobody blows the all clear whistle. But I would say there's certainly a desire in the corporate base to produce growth, and when they see strong underlying synergies, people will take action, but they need a backdrop in which they feel comfortable executing. And as I said, the trend in terms of the backdrop, regardless of the fact that this quarter there might have been a step back in terms of confidence and an increase in uncertainty, the trend is positive. But this is a multiyear phenomenon, obviously.

Douglas Sipkin - Susquehanna Financial Group

Shifting gears, maybe you could just spend a little bit more on the asset management business. Maybe big picture, just from my vantage point, it seems like you guys are doing a little bit more to buy, build, etc. there. Do you guys have any long term targets as to how big you want that business to be relative to the whole organization? Obviously it's a capital light business. I know you guys have done some smaller acquisitions here recently. So any color on strategic steps you guys are taking there that are different from maybe three, five years ago?

Harvey Schwartz

Well, the focus has been very intense for several years. But as I said before, it's a bit old-fashioned. The primary focus is performance, and with performance we know we will build assets. We'll look, from time to time, at acquisitions, if we think they make strategic sense and it fits our business, and it's additive to our clients and to our performance. But as I said, we're very pleased with the results in the growth, but we're relying on something that's a little bit old-fashioned.

Operator

Your next question is from the line of Fiona Swaffield with RBC. Please go ahead.

Fiona Swaffield - RBC Capital Markets

I just had a follow up question on the Basel III all-in look through number, I think the 9.8 versus the 9.3. Could you talk us through, it looks to me like the deductions have gone down, because obviously you've got buybacks offsetting profit or more than offsetting profit. And I think the [unintelligible] you said were down $10 billion. Correct me if I'm wrong. But is there something going on in deductions? Or something else?

Harvey Schwartz

You'll recall at the end of the second quarter obviously we got the finalized rule. One of the things about that rule, obviously, is there's the financial institutions deduction. What you're really seeing is a reduction in a component of that risk, which isn't a deduction from capital, as you know. And we've talked about this before. The fact that our teams have both the tools and the ability to manage the balance sheets, what you're seeing now that we've seen the finalized rule is you're seeing them take actions that affect the ratio. So, for example, selling certain cash assets.

Fiona Swaffield - RBC Capital Markets

So it's not private equity deductions, per se, it's the other deductions?

Harvey Schwartz

No. You're bringing up the subtlety of the significant versus the nonsignificant. And for anyone else on the call who's less fluent in this minutiae, I'm happy to set up some follow up time with Dane and the team. The significant deductions obviously they will come with harvesting over time. Because we're in the funds with our clients.

Operator

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

Guy Moszkowski - Autonomous Research

Just a question on the investing and lending, the equity side. So the language that you used in the press release and I think you also said in your prepared remarks sort of made a distinction between corporate performance and company specific events. Could we generally think in our mind that the corporate performance ones are probably marks to a model, and then the company-specific events are more going to be either realized gains or marks to a market value that's visible?

Harvey Schwartz

What I was referring to in the opening remarks, obviously, is public market equities versus private equities. And we're very rigorous, as you know, in our mark-to-market policies. So we incorporate all variables. I'll list a few. Obviously specific performance of the asset, which we have visibility into, and the market environment and pending events. So if, for example, we think an asset is going to go public in the next quarter, potentially, that's the strategic plan for the enterprise, or a subsequent quarter, if that's there, then we'll have other valuation techniques, which we're in receipt of, obviously. But it's a very rigorous process, as you know.

Guy Moszkowski - Autonomous Research

Oh, yeah. I don't doubt that at all. Is there any color that you can give us on the gains that you recognized in the quarter, how much of that was actually a realized gain versus some element of a mark?

Harvey Schwartz

Well, it's all fair value, right? So I think if you're asking about specific monetizations, no, I haven't delineated that. But we're marking the balance sheet every day, as [unintelligible] is realized.

Guy Moszkowski - Autonomous Research

Let me move on to the SLR. You're right, if the [unintelligible]'s off, and you're already basically compliant, as you said. So you're not going to rush to do mitigation things. But you also had commented on the fact that compression and reduction of notionals was probably a healthy thing. So I'm wondering to what extent you're engaged in more compression, more maybe looking to redocument existing transactions that are long term in nature into central clearing so you can get rid of the CVA drag on the denominator, the leverage ratio, things like that.

Harvey Schwartz

So again, just from a risk management perspective, we've always been very engaged in trying to reduce gross notionals. As I said, it's just a good way to run the business. Now, because of the developing rule sets, the whole marketplace is more engaged, and we're very engaged. And that's not to imply people weren't as engaged as we are.

The nuance I was trying to explain earlier was that people historically, over many, many years, everyone likes to reduce gross notionals, but sometimes couldn't agree on cost. Now, there's just a greater forcing function, so there's more of a tailwind to everybody reducing gross notionals.

Now, again, this is a little bit of the process of, I think, how we certainly - I suspect the rest of the industry - the leverage ratio, what it encourages you to do is to basically rank the exposures basically from a return on asset perspective, start with low ones, and mitigate from there. And this would be high on the list for the whole industry, I assume.

Guy Moszkowski - Autonomous Research

So I guess that I could interpret your remarks to mean that you probably are spending quite a bit more time and hopefully getting more resolutions when you're sitting across a table from a counterparty who's another dealer and getting these notionals down and maybe moving some of these elongated transactions, as I said, into a central clearing environment? Or does that not really work that well?

Harvey Schwartz

That's a correct assessment, but it's just started. We just started, and the industry just started, so it's early going. But the answer is yes.

Guy Moszkowski - Autonomous Research

Fair enough. Like I said, I was just trying to get a sense for the direction of travel in that. And then just a final question on the intersection of the I&L business and the comp ratio reduction. I know you've generally had this policy of straight lining it for three quarters, but isn't it economically logical to conclude that the reason that the ratio came down as much as it did is just the degree to which your profit mix this quarter was driven by investing and lending activities that really have inherently a very low compensation ratio?

Harvey Schwartz

Again, no change in philosophy. I want to be really clear with everyone. It's our best estimate. It reflects the collective contribution of all businesses, certainly not an individual business segment. And we have reduced before in the third quarter. So it's not completely out of sync would have what we've done historically, but it does reflect all these things I talked about earlier, the fact that we're running $500 million ahead, we have more visibility into year-end - which is another way of saying best estimate. We have more visibility into year-end, and of course the cost reduction efforts give us flexibility.

Operator

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

Brennan Hawken - UBS

Just a quick one, at this point, and it's again on comp. Sorry. I hate to beat a dead horse, but just kind of want to take a slightly different angle on this. During earnings here we've seen another dominant fixed franchise cut their comp ratio kind of materially this quarter too. And obviously you can't speak to the actions of a competitor, but in your view, is it appropriate to assume that as an industry we are maybe rationalizing FICC to a new regulatory and business environment through these actions?

Harvey Schwartz

I have, as you know, zero visibility. You'd have a lot more visibility in your engagement with our competitors than I would. Not to wax on and make the call long, but I remember the first day I showed up at Goldman Sachs. One of the first things I was taught and mentored was that compensation was first and foremost how the firm did, then how your division did, then how your business unit did, and then how you did as an individual.

We haven't changed any of that. If anything, we're protective of that cultural mantra, and I hope that every new summer hire that we brought in this year, I hope they got the same lecture I had back then. So, again, it's the same culture, and you're just seeing it based on performance. And when I say performance, everything: the year to date run rate being ahead in revenues, and also all the multiyear efficiency efforts we've built in.

Operator

Your next question is from the line of Christopher Wheeler with Mediobanca. Please go ahead.

Christopher Wheeler - Mediobanca

A couple of related questions. The first one really just touches on what the last gentleman said, because I suppose you've been very, very honest about how difficult the quarter was for fixed income. But I guess we've seen so many headwinds build up around fixed income since the crisis, and then during the summer we obviously saw the possible issues around tapering, which will come, of course, not just in the United States but elsewhere, where a lot of liquidity will come out of the market, interest rates go up.

And you guys have tended to be at the cutting edge of thinking through these issues, as you were post-crisis. And I suppose what I'm interested in, and maybe compensation is one of the issues, but what else are you thinking about in terms of that withdrawal of liquidity, which may mean that if you want a market where fixed income revenues are not going to be anywhere near as robust as they were even in the post-crisis period, when you were having to deal with Basel III and the other capital issues?

And I guess relating to that, perhaps linked to it, the 10.4% return on equity, I know you're not happy with that. You talked about the legacy assets. You've always talked about when the markets pick up you will really perform very strongly, because of your clear strengths in the market. But I suppose when I look at some of your diversified competitors in the investment banking space, they are already moving towards the mid-teens.

And I'm just wondering again, given that you're normally at the front edge of these things, at what point do you start looking at the business model and enhancing it by looking to broaden it rather than actually perhaps narrow it, as you had to do with Dodd-Frank etc.?

Harvey Schwartz

Okay, that's a big question. So, in terms of fixed income, we don't really try and predict what happens in terms of the market reaction. And what I mean by predict, I mean over a multiyear period - and let's just say we go into a period of rising interest rates - a lot of what will determine the size of the market for fixed income - when I say that, I mean the activity levels for us and all of our competitors - won't be the absolute level of rates, it will be the backup of the environment. And so, again, an environment where it isn't so news-sensitive, and clients were high conviction, low conviction, and very nervous, is a much better environment for our clients, which, by the way, translates generally to better volumes in the marketplace and better liquidity for everyone.

The best case history is really the equity business, which as you know went through a massive transformation from the late 90s to today, as an industry, and yet revenues continued to grow. So our responsibility to our clients and in running the business is how we adapt.

So in the past we've been good adapters, and we just have to continue to adapt. But the cornerstone of adapting will be the interface with the clients and making sure that we deliver to them. As we've done in the past, we just need to continue doing it. But the changing interest rate environment, that will determine strategy over a multiyear period.

As it relates to returns, look, we strive every day to ensure that we have the highest absolute returns while managing the firm conservatively. And we really want to make sure we have the highest relative returns. For us, this has been a good relative return environment. We'd love to see better absolute returns, but it's been a pretty strong relative environment.

Christopher Wheeler - Mediobanca

We just talked about rising rates on taper, but [unintelligible] liquidity as well, which I think was one of the great fears that we've just seen, and that does suggest the need to realign the business. And I think what you're saying is that you'll just keep an eye on that. You have no plans at the moment to do that in respect to something that hasn't actually started, albeit it will keep going for a long time, once tapering starts.

Harvey Schwartz

What's critical about certain changes, or whether or not they change what clients need first, and then how it impacts market structure. I don't see anything in a rising rate environment that changes market structure. What will change is how clients view the marketplace. Again, if it's a high confidence, we're back to more certain economic growth, several years from now, and interest rates are higher, that could be a very positive environment for fixed income investors. But it might not be. All I know is we'll have to adapt and make sure we respond to it better than our competitors.

Operator

Your next question is from the line of Devin Ryan with JMP Securities. Please go ahead.

Devin Ryan - JMP Securities

With respect to maybe some of the positive secondary impacts of regulation, could you maybe update us on which businesses you feel like you've been gaining some market share in, and maybe where you're seeing some opportunities as competitors are just reevaluating their strategies or how they're allocating resources?

Harvey Schwartz

I think it's too early to see that. Obviously earlier in the year and continuing we've seen some pullback from some competitors. I think that's a multiyear phenomenon as it relates to to impact of regulation. And so we'll see that again over time. That will be a big part about this operating flexibility that I was talking about earlier.

The real differentiating characteristics firm by firm - and we all will live with the same rules, we'll have all the same resources - is which firm can better deliver to their clients and which firm can better adapt. And I've talked about this a lot. Adapting too early can be a mistake, and adapting too late can be a mistake, and so we'll be watching it very, very closely and doing everything we can to deliver to our clients.

Devin Ryan - JMP Securities

And then just lastly, not to beat a dead horse on FICC, but we have seen some flows out of bond funds in recent months, and understand they're small in the absolute, but just given your exposure to institutional asset managers, as you mentioned, did you see any change in client behavior in the quarter or anything that maybe was a little bit concerning just with some of the outflows out of bond funds?

Harvey Schwartz

It's been a while now, but obviously I grew up in that business, and I co-headed it before my current responsibilities. I think what clients did is just normal client risk management. Maybe a little different than what you would have seen pre-crisis, because people are just very, very sensitive to potential tail risk. Quite frankly I think it's a good thing for the marketplace, not a bad thing. But no, I think all the behavior was very predictable.

Operator

And at this time, there are no further questions. Please go ahead with any closing remarks.