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Texas Capital Bancshares, Inc.

Q4 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

Rob Holmes - *President, Chief Executive Officer*

Matt Scurlock - *Chief Financial Officer*

Jocelyn Kukulka - *Director of Investor Relations*

Operator

Hello. And welcome to TCBI's Third Quarter 2023 Earnings Call. (Operator Instructions) It's my pleasure to now hand you over to your host, Jocelyn Kukulka, head of Investor Relations. Please go ahead when you are ready.

Jocelyn Kukulka

Good morning. And thank you for joining us for TCBI's fourth quarter 2023 earnings conference call. I'm Jocelyn Kukulka, Head of Investor Relations. Before we begin, please be aware this call will include forward-looking statements that are based on our current expectations of future results or events. Forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from these statements. Our forward-looking statements are as of the date of this call, and we do not assume any obligation to update or revise them. Statements made on this call should be considered together with the cautionary statements and other information contained in today's earnings release and our most recent annual report on Form 10-K and subsequent filings with the SEC. We will refer to slides during today's presentation, which can be found along with the press release in the Investor Relations section of our website at texascapitalbank.com. Our speakers for the call today are Rob Holmes, President and CEO; and Matt Scurlock, CFO. At the conclusion of our prepared remarks, our operator will open up a Q&A session. I'll now turn the call over to Rob for opening remarks.

Rob Holmes

Thank you for joining us today. Our firm materially progressed its transformation in 2023, increasingly translating a now sustained track record of strategic success into financial outcomes consistent with long-term value creation. We are now operating a unique Texas-based platform, providing our clients with the widest possible range of differentiated products and services on parity with the largest money center banks. And we are positioned to serve as a relevant trusted partner for the best clients in all of our markets.

We know that the success of our clients will define our firm. A core element of our strategy is maintaining balance sheet positioning sufficient to support our clients through any circumstance. Our industry-leading liquidity and capital afford us a competitive advantage through market and rate cycles.

Year-end CET1 at 12.6% ranked fourth amongst the largest banks in the country, tangible common equity to tangible assets of 10.2% ranked first among the largest banks in the country and an all-time high for the firm. And liquid assets of 26% allows for a consistent and proactive market-facing posture as we are distinctly capable of supporting the diverse and broad needs of our clients in what continues to be a dynamic and challenging operating environment for all industries.

We have, over the last three years, clearly prioritized enhancing the resiliency of both our balance sheet and business model over near-term growth and earnings. The extensive investments made to deliver a higher-quality operating model, supporting a defined set of scalable businesses is resulting in the intended outcomes. The entire platform contributed to our full year adjusted financial results with fee

revenue growth of 60%, PPR growth of 14% and EPS growth of 23%. The foundation of our transformation is a deliberate evolution of our Treasury Solutions platform from a series of disparate deposit-gathering verticals into a best-in-class payments offering, able to successfully compete for win and serve as the primary operating relationship for the best clients in our markets.

The volumes flow through our payment system have increased 23% in the last two years, contributing to an 11% improvement in gross payment revenues in 2023 as treasury business awarded in prior quarters continues to ramp. Our firm now provides faster, more seamless client onboarding than the major money center banks and ongoing frictionless client journeys that match or exceed theirs with high-touch, local service and decisioning. This theme extends to our investment bank as a capability set on par with the top Wall Street banks ensures clients will never outgrow the services we can provide for them.

Market affirmation was evident this year as investment banking and trading income increased 146%, with the largest product offerings, syndications, capital markets, capital solutions, M&A and Sales & Trading each contributing over $10 million in fee-based revenue, a significant milestone for a still maturing offering. When we launched the strategy, we acknowledge that results generated by the newly formed investment bank would not be linear, and it would take several years to mature the business with a solid base of consistent and repeatable revenues. Despite broad-based early success, we expect revenue trends to be inconsistent in the near term. This same is all firms as we work to translate early momentum into a sustainable contributor to future earnings.

The firm has been and remains committed to banking the mortgage finance industry as it weathers the most challenging operating environment in the last 15 years. Over the previous 18 to 24 months, we have refocused client selection and improved the service model as we look now to expand market share, but to instead deepen relationships through improved relevance with the right clients. Of those that started with just a warehouse line, 100% now do some form of the treasury business with Texas Capital. And nearly 50% are open with a broker-dealer, paving the way for improved utilization of our sales and trading platform and accelerated return on capital.

While the rate environment in '23 did disproportionately impact this client set as evidenced in our financial results for the quarter, which Matt will walk you through, our commitment to effectively serving these clients will, over time, deliver risk-adjusted returns consistent with firm-wide objectives.

A foundational tenet of the financial resiliency we have established and will preserve as continued focus on tangible book value, which finished the year up nearly 9%, ending at $61.34 per share, an all-time high for our firm. While we continue to buy capital use towards supporting franchise accretive client segments where we are delivering our entire platform, we do recognize that at times of market dislocation it can be prudent to selectively utilize share repurchases as a tool for creating longer-term shareholder value.

During 2023, we repurchased 3.7% of total shares outstanding at a weighted average price equal to the prior month tail book value and at 86% potangible book value when adjusting for AOCI impacts. We entered 2024 from a position of unprecedented strength, fully committed to improving financial performance over time.

Intentional decisions made over the last three years have positioned us to deliver attractive through-cycle shareholder returns with both higher quality earnings and a lower cost of capital as we continue to scale high-value businesses through increased client adoption, improved client journeys and realized

operational efficiencies. All objectives that we made significant headway on this year. Thank you for your continued interest in and support of our firm. I'll turn it over to Matt to discuss the financial results.

Matt Scurlock

Thanks, Rob. Good morning. Starting on Slide 4, which depicts both current quarter and full year progress against our stated 2021 strategic performance drivers. Full year fee income as a percentage of revenue increased to 15% this year, up $60 million or 60% year-over-year as our multiyear investment in products and services to provide a comprehensive solution set for our clients continues to translate into improved financial outcomes. Treasury product fees were $7.8 million in the quarter, up 10% from the fourth quarter of last year as we continue to add primary banking relationships at a pace consistent with our long-term plan.

We're also increasingly able to solve a wider range of our clients' cash management needs as outsized investments in our card, merchant and FX offering that sure the firm's treasury capabilities are on par or superior to peers in a highly competitive market. Wealth management income decreased 7% during the year, in large part due to temporary client preference from managed liquidity options given market rates.

Similar to the treasury offerings, we are, at this point, more focused on client growth and platform use and our quarterly changes in revenue contribution. Year-over-year growth in assets under management and total clients of 8% and 11%, respectively, is on pace with plan as we continue to invest in this high potential offering heading into 2024.

Investment banking and trading income of $10.7 million decreased from consecutive record levels in the prior four quarters. which were marked by a series of marquee transactions on a still emerging platform. Results are generally representative of an initial baseline level of quarterly revenue. And while there will always be some volatility associated with this specific line item, we expect increasingly broad and granular contributions to over time, at least partially alleviate expected quarterly fluctuations associated with the new business. In all, we are both pleased with the 64% growth in our fee income areas of focus for the year and their collective ability to further differentiate our value proposition in the market.

As expected, total revenue declined linked quarter to $246 million as both net interest income and noninterest revenue pulled back from respective highs experienced in the preceding quarters.

Net interest income was pressured primarily by anticipated seasonal and cyclical impacts of mortgage finance as peak stuff funding levels reduced net interest income by $18 million, roughly equivalent to the firm's total quarter decline. Total adjusted revenue increased $99 million or 10% for the full year, benefiting from a 60% increase in noninterest income, coupled with disciplined balance sheet repositioning into higher earning assets associated with our long-term strategy. Quarterly total adjusted noninterest expense increased less than 1% linked quarter and is nearly flat relative to adjusted fourth quarter of last year. During the year, we have demonstrated our ability to realize structural efficiencies associated with our go-forward operating model, which are improving near-term financial performance

while also enabling select investments associated with long-term capability build. Taken together, full year adjusted PPNR increased 14% to $338 million.

This quarter's provision expense of $19 million resulted primarily from an increase in criticized loans as well as resolution of identified problem credits via charge-off. Full year provision expense totaled $72 million or 45 basis points of average LHI, excluding mortgage finance loans, consistent with communicated expectations. Adjusted net income to common was $31 million for the quarter and $187 million for the year, an increase of 17% over adjusted 2022 levels. This financial progress continues to be supported by a disciplined and proactive capital management program, which also contributed to a 23% increase in year-over-year adjusted earnings per share to $3.85.

Our balance sheet metrics continue to be exceptionally strong. Period-end cash balances remain in excess of 10% of total assets with a $950 million decline this quarter mainly due to anticipated annual tax payments remitted out of mortgage finance deposit accounts. Ending period LHI balances declined by approximately $270 million or 1% linked quarter, driven predominantly by predictable seasonality in the mortgage finance business, whereby both average balances and end-of-period balances declined, reflecting slower nationwide home buying activity in the winter months.

Total LHI, excluding mortgage finance, increased $181 million during the quarter and 8% for the year. Commercial loan balances remained relatively flat during the quarter, increasing $45 million. which fell marginally unfavorable to near-term earnings expansion, obscures continued strong underlying momentum in the commercial businesses. New relationships onboarded in 2023 were up nearly 10% relative to elevated 2022 levels. With the proportion of new activity that includes more than just a loan product trending over 95%. The noted progress on winning client treasury business is highly correlated with the increasing percentage of commercial relationships in which we are the lead bank. This manifests in the fee income trends noted earlier as we continue to provide value in multiple ways for clients for whom we choose to extend balance sheet. We are nearing the end of a multiyear process of recycling capital into a client base that benefits from our broadening platform of available product solutions delivered within an enhanced client journey. And after consecutive years of capital build, would expect the sustained pace of new client acquisition to result in modest balance sheet releveraging over the next year. Period end real estate balances increased $142 million or 3% in the quarter, as payoff rates normalized from record highs in the prior year.

Despite a modest increase, we are positioned for a continuation of realized payoff trends in the medium term. Our clients' new origination volume also remained suppressed. With new credit extension largely focused on multifamily, reflecting both our deep experience in the space and observed performance through credit and interest rate cycles. Average mortgage finance loans decreased $751 million or 16% in the quarter, to $3.9 billion as the seasonality associated with home buying approaches its annual low moving into Q1. While both fourth quarter and full year average balances were consistent with communicated guidance, we did experience a late quarter increase in client activity as mortgage rates declined by nearly 120 basis points of fourth quarter highs in late October, resulting in an ending balance of approximately 5% higher than expectations beginning the quarter. As you know, Q4 and Q1 are the seasonally weakest origination quarters from a home buying perspective. And after a difficult fourth quarter for the mortgage space, our expectation remains that the next quarter will be amongst the

toughest the industry has seen in the last 15 years. Despite the modest rate pullback, estimates from professional forecasters, suggest total market originations to contract modestly linked quarter. Should the rate outlook remain intact, industry volumes are expected to recover over the duration of the year with the same professional forecasters expecting a full year increase of 15% in total origination volume. Should origination volume recover consistent with market expectations, we would anticipate a comparable increase given our clients' strong positioning.

Ending period deposits decreased 6% quarter-over-quarter with changes in the underlying mix reflective of both predictable seasonality and continued funding transition in a tightening rate environment. Sustained focus on leveraging our cash management platform into deeper client relationships has driven outperformance relative to the industry with annual deposits just 2% lower year-over-year. When excluding predictable fluctuations in mortgage finance deposits, our deliberate reduction of index deposits and reduced reliance on broker deposits, year-over-year growth of 4% reemphasizes our success in attracting quality funding associated with core offerings during a challenging year. Period end mortgage finance noninterest-bearing deposit balances decreased $1.7 billion quarter-over-quarter as expected. As escrow balances related to tax payments are remitted beginning in late November and run through January, at which point the balances begin to predictably rebuild over the course of the year. Average mortgage finance deposits were 142% of average mortgage finance loans, consistent with our guidance of up to 150%. As the system-wide contraction and mortgage origination volume weighs on clients' short-term credit needs. We expect a ratio of average mortgage finance deposits to average mortgage finance loans of approximately 120% in the first quarter, modestly easing pressure on mortgage finance yields as origination volumes begin to recover through the year. As a reminder this dynamic is driven by client level relationship pricing, resulting in an interest credit rate applied to the mortgage finance noninterest-bearing deposits that is realized through yield.

Average noninterest-bearing deposits, excluding mortgage finance, was $3.6 billion in the quarter, in line with third quarter period end, as previously described trends whereby select clients shifted excess balances to interest-bearing deposits or to other cash management options on our platform continues to slow. Ending period noninterest-bearing deposits, excluding mortgage finance, remains 15% of total deposits, is flat quarter-over-quarter. Our expectation is that this percentage remains relatively stable in the near term. Broker deposits declined $477 million during the quarter as growth in client-focused deposits consistent with our long-term strategy remains sufficient to satisfy desired near-term balance sheet demands. We anticipate additional declines in brokered CDs during the first quarter as $300 million with an average rate of 5.2% is likely to mature without full replacement.

As expected, our modeled earnings at risk evolved consistent with indications at a slowing tightening cycle as the increase in modeled up betas lessened remaining sensitivity to further upward rate pressure as measured in a plus 100 basis point shock scenario from $29 million in Q3 to $14 million in Q4. Downward rate exposure remained relatively flat quarter-over-quarter at 4.4% or $40 million in a down 100 basis point shock scenario. Proactive measures taken earlier in the year to achieve a more neutral position at this stage of the rate cycle had and produced the intended outcome. It is important to note these are measures of net interest income sensitivity and do not include inevitable rate-driven changes in loan volume or fee-based income. Further, the disclosed downrate deposit betas are higher than what are

contemplated in the guidance as we do not expect deposit pricing to immediately adjust should the Fed deliver against market rate expectations. There were no new bond purchases in the quarter, but we are likely to resume cash flow reinvestment in anticipation of a lower rate environment moving into 2024.

Net interest margin decreased by 20 basis points this quarter and net interest income declined $17.4 million, predominantly as a function of the previously described impact of relationship pricing on mortgage finance loan yields and increased interest-bearing deposit volume tied to growth in client balances, partially offset by increased income on higher average cash balances.

The systematic realignment of our expense base with strategic priorities continues to deliver the expected efficiencies associated with a rebuilt and more scalable operating model. Even when accounting for the seasonal factors associated with Q1, salaries and benefit expense has declined three consecutive quarters while retaining in excess of 2x the number of frontline employees since the transformation began.

Preparation for an inevitable normalization in asset quality began in 2022, as we steadily built the reserve necessary to both address known legacy concerns and align balance sheet metrics with our foundational objective of financial resilience. The total allowance for credit loss, including off-balance sheet reserves increased $5 million on a linked quarter basis to $296 million or 1.46% of total LHI at quarter end, up $21 million year-over-year in anticipation of a more challenging economic environment, while our ACL to nonaccrual loans stands at 3.6x. For comparison purposes, the total ACL ratio is 24 basis points higher now than during the pandemic peak in third quarter two020. Criticized loans increased $61 million or 9% in the quarter to $738 million or 4% of total LHI. As increases in special mention of predominantly commercial real estate loans were only partially offset by payoffs and upgrades of commercial loans. As in prior quarters, the composition of criticized loans remains weighted towards commercial clients with dependencies on consumer discretionary income, plus well structured commercial real estate loans supported by strong sponsors. During the quarter, we recognized net charge-offs of $13.8 million, predominantly related to partial charge-offs of two relationships originated in 2018. A commercial credit dependent on consumer discretionary income and hospitality loan, which has been unable to recover post the pandemic.

Capital levels remain at or near the top of the industry and are near all-time highs for Texas Capital. Total regulatory capital remains exceptionally strong relative to the peer group and our internally assessed risk profile. CET1 finished the quarter at 12.65%, 5 basis point decrease from prior quarter. Tangible common equity to tangible assets finished the quarter at 10.22%. We remain focused on managing the hard-earned capital base in a disciplined and analytically rigorous manner, focused on driving long-term shareholder value. In aggregate, during 2023, we repurchased approximately 1.8 million shares or 3.7% of the shares outstanding at year-end 2022 for a total of $105 million at a weighted average price approximately equal to prior month tangible book value.

Our guidance accounts for the market-based forward rate curve, which assumed Fed funds of 4.25% exiting the year. For 2024, we anticipate mid-single-digit growth in revenue, supported by continued execution across the income areas of focus and the slowing of multiyear capital recycling efforts. We should increasingly enable our sustained momentum in new client acquisition to manifest into modest risk

appropriate balance sheet expansion. This is in part supported by well-signaled intent to move towards an 11% CET1 ratio, which given our risk-weighted asset heavy commercial orientation should still result in sector-leading tangible common equity levels.

We expect multiyear investments in infrastructure, data and process improvements to continue yielding expected operating and financial efficiencies which should enable targeted additional investment in talent and capabilities while limiting full year noninterest expense growth to low single digits. Acknowledging near-term headwinds associated with the mortgage industry, we expect resumption of quarterly increases in year-over-year PPNR growth to begin in the second half of the year, accelerating as we enter 2025.

Finally, despite recent market sentiment favoring a potential softer landing, we maintain our conservative outlook and believe it's prudent to consider potential for further downside stress, therefore, elevating our annual provision expense guidance to 50 basis points of LHI, excluding mortgage finance. Operator, we'd now like to open up the call for questions. Thank you.

Operator

(Operator Instructions) And our first question comes from Ben Gerlinger with Citigroup.

Ben Gerlinger

I was curious if we could just kind of parse through the revenue guidance a little bit. That's helpful given the kind of the year-over-year comp on PPNR, but I get that most of the revenue upside here, we should be expecting from fees. But when you think about just the balance sheet itself, I know you referenced that betas are probably limited for the first couple of cuts. But when we exit the year, can you kind of give just your overall or kind of 10,000-foot view on deposit betas after we get that fifth or potentially sixth cut. I think it's probably limited in the beginning, but towards -- we get to the end, just any thoughts on that?

Matt Scurlock

Yes, Ben, happy to take that. So I mean, bifurcated between interest-bearing deposit betas and then the cost of funding within the mortgage finance business. So the model down rate scenario for interest bearing deposit betas and the static balance sheet is 60%. You're not going to hit 60% over the first five cuts. You probably hit half of that as it builds over the duration of that cut program.

We have modeled in our guide expectation that you actually see interest-bearing deposit costs continue to drift up at a pace similar to what we experienced in the last quarter until if and when the Fed actually takes action. A bit of a different scenario as it relates to mortgage finance, which obviously had a significant impact this quarter. So of that $17 million, $18 million decline in net interest income is a great chart to depicted on one of the slides that suggests you could take the entirety of that to mortgage

finance. The severity of the impact of this historical rate increase has had on that industry is pretty difficult to overstate. So there's really no precedent to look back to -- there's certainly no Texas Capital Bank experience in which to pull insights from -- so as volumes just evaporated from mortgage originators over the last year, deposits moved to compensated at a pace well in excess of historical experience. That really started to accelerate toward the middle of the year. And the ultimate deposit beta, which flows through relationship pricing on the yield accelerated pretty much consistent with the 80% interest-bearing deposit beta. So for us, that definitely impacts balance sheet positioning. You could see that as we pause cash flow reinvestment on the bond portfolio and ultimately stop the hedge program. We realized with deposit rates rising faster on that business, we were going to hit neutral, a bit earlier than anticipated in a rising rate environment. But I think importantly, as the Fed is signaling that they may be done raising rates and are more likely to start to cut. We also realized we weren't going to need as much downside protection because we would expect those mortgage finance deposits to reprice down at a beta consistent with the 80% on the way up.

Ben Gerlinger

Got it. It's helpful color. I definitely have to look at the transcript again to make sure I have everything but.

Matt Scurlock

That was a heck of a first question ben

Ben Gerlinger

Well, yes, I mean, that's really the million-dollar question at this point, but -- and that's not just for you guys, that's everybody. So when you guys specifically, it seems like this multiyear process. You have all the seats filled with people now is just kind of execution on the plan. It doesn't help that the Fed moved pretty dramatically and it could move pretty dramatically again. But when you just think about overall expenses, what else -- what else are we spending money on? I guess that the ramp is not nearly as much, but what other investments other than just people is it technology? Or is it really just -- do you think the revenue could show up so that some of its compensation. Just kind of asking why we still see upside in expenses?

Matt Scurlock

Yes, happy to talk about that, Ben. We've been really consistent in describing our objective around noninterest expense, which is to really improve the productivity of the expense base. And it was our view that you don't show up in a challenging revenue environment and then make the determination you want to invoke expense discipline. We think that instead, you have to make multiyear investments, process infrastructure, technology which enables you over time to a lower risk, improve throughput, make these for clients to do business with you. That makes your business better and then ultimately has a nice byproduct of reducing structural operating expense. You could see that 2023 expense base really near those priorities, where the multiyear build and middle and back office has really enabled us to remove a lot of manual tasks, which improves the employee experience and also enables us to continue to invest in the front line. So I think in '24, you'll see the typical $8 million to $10 million of seasonal comp expense in the first quarter. And then full year, you should see -- the full year, you'll see salaries and benefits grow at a pace in excess of the low single-digit total noninterest expense guide. For all noninterest expense, not called salaries and benefits you can peg that at about $70 million. And then the underlying composition will continue to bias towards tech and comms as we reach our target level of change the bank project portfolio this year. Rob, do you want to talk through capabilities?

Rob Holmes

Yes. I would just say that I think Matt said it very well. I think third quarter or third quarter salaries and benefits were down 5% when we've doubled the frontline bankers. So that tells you -- that kind of quantifies Matt's comments about repositioning the expense base our successes in doing so. But to your point about the expenses already being in the platform, the platform is fully loaded with all the solutions that we wanted for our clients. So, we've endured all the expense and both from product and services, a new commercial card, a new merchant, new lockbox, new payments platform. We basically have a brand-new bank, state-of-the-art 2023 bank payments bank. And we're rolling that out to clients at a record pace and onboarding clients at a record pace. '22 was a record and '23, and we expect '24 to do that again. So -- the pipelines are full, the expense base is fully loaded, and the platform is built.

Operator

We now turn to Matt Olney with Stephens.

Matt Olney

There was some commentary in the outlook about modest balance sheet releveraging and as well as moving that CET1 capital ratio lower during the year. Any more color on how we achieved this, whether it's stock repurchase activity, accelerated loan growth? Just any more details behind that?

Matt Scurlock

Yes, Matt, thanks for the question. We've been vocal about how professional we've been since Rob's arrival about repositioning that capital base and at the end of year three feel like that pace should begin to slow in 2024. So to Rob's comment, we had a record year of new client acquisition in 2022. We beat that by 10% in 2023, and we'd expect to do the same in 2024. So sustaining that pace of client acquisition, coupled with now fewer identified opportunities for needed capital recycling should ultimately result in some increased balance sheet growth. And part of having -- part of the deliberate build to peer-leading levels of tangible common equity of tangible assets is to just ensure you've got balance sheet capacity that's adequate to support any necessary growth from the client base. So you should see the benefits of our sustained client acquisition begin to show up and improve loan growth.

Rob Holmes

Yes. I would say that what Matt's said is spot on, but I don't know if you, one, would appreciate how material that that is the recycling. So think about taking a loan-only subpar return loan to a client that we don't necessarily aspire to bank anymore and replacing that with a new client, which is a sector-leading great company, great management team, been through balance sheet committee, where we are earning more than our cost of capital is on the relationship because we're doing more than the loan only. Matt said in his comments 95% of names coming through balance sheet committee today are more than loan only. So the other 5% (indiscernible) go for a longer-term strategic view. So recycling the loan, if we did nothing else but to just sit on what we did which is recycling the capital, you would see over time a much improved return of that capital as the product or service ramp that we do with the client.

Matt Scurlock

That excess capital also gives you a bit more downside net interest income, the sensibility than, I think, what is currently appreciated or currently depicted in the static balance sheet, 100 basis point shock scenarios. So we carry that excess capital, so we can support clients through any cycle. And this is the historically worst point of a cycle for mortgage finance, but it's not always going to be like that. So professional forecasters of which would be -- we talked earlier -- or we joked earlier in the room it'd be a pretty tough time to be a professional forecaster. But professional forecasters suggest that one to four family mortgage originations this year is going to increase by about 15%. So if we think about a down 100

basis point scenario, just anticipated mortgage finance growth and the associated revenue is sufficient to offset that $40 million shock that's shown in the sensitivity modeling. And then, of course, because of the real focus on building fee income verticals over the last few years, you would be able to generate additional revenue in a down-rate environment on those offerings as well.

Matt Olney

Okay. Okay. That's helpful. I think I heard most of that. There's some feedback coming from the line, but I think I heard most of your commentary. And just as a follow-up, within that revenue guidance of the mid-single digits, any more color on how much of that will come from fees versus NII?

Matt Scurlock

As Rob mentioned, the pipelines associated with all of the fee income businesses are as good as they've ever been. So we increased gross PxV by more than 10% over the last three years. We've got premium offerings in FX, card, and merchant. The current pipeline in the treasury business is equivalent to the full year 2023 realized business. After fourth quarter for the Investment Bank, where you had all offerings other than sales and trading have their worst quarter of the year. The delta between the realized $11 million and in the mid-teens guide was solely related to client transactions we're working on pushing into 2024. That investment banking pipeline has significantly improved year-over-year. So we now have the right coverage, you've got direct connectivity and we've got real earned market momentum. So I'd expect that to -- all those fee income areas of focus to increase both in terms of revenue this year and in a percentage of total contribution.

Rob Holmes

I'll just highlight one other thing. What Matt said about PxV growing in addition to 10% each year for the past three years, the market norm that I'm used to historically is like 2%. So to be growing that business at 11% is something that I have not seen before, especially on a sustained basis in my career. So really, really good about that. That has to do with client selection, has to do with an infrastructure that is as good as any money center bank, has to do with new client journeys, which is the digital onboarding able to ramp faster and bring revenues forward. So that's going great, and by the way, the ECR goes down, when rates go down so you actually realize more fees. So the contribution there is really really good. Then one last thing, this part of the fee thing. In the investment bank its hard to in part the importance of a broad $10 million plus fee revenue contribution from five different areas of a brand new investment bank. Syndications, capital market, capital solutions, M&A, and sales and trading. That's super encouraging and a very healthy investment bank.

Operator

Our next question comes from Woody Lay with KBW

Woody Lay

I wanted to start on the deposit base. Brokered deposits continued to move lower in the quarter. And then the slide, you called out that the funding base continues to transition to a target state composition. Can you just remind us what you think the target state composition looks like when we look out a couple of years from now?

Rob Holmes

We will never hit our target state composition of a funding base, Woody. And if any bank's CEO tells you they have, be concerned. So we will always look to improve the funding base. We have made significant progress. With our funding base, it's dramatically important, as we said. We know every client -- commercial client that is on the platform that relationship with them. As you saw brokered deposits have shrunk probably like $9 billion plus, I got here to just over $1 billion. So, we feel like we've made a dramatic improvement in the quality of the deposit with the quality of client. Also there will be no -- there will be no (indiscernible) in terms of target deposit base.

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Woody Lay

That makes sense. Maybe moving to the asset sensitivity. You touched on that that have moved lower as evident on Slide Nine. Does the seasonality and mortgage impact -- does that impact the disclosure? Or is that not really an impact?

Matt Scurlock

No. I mean, that definitely impacts the disclosure. So the disclosed sensitivity is based off end-of-period balance sheet. So should you have an end-of-period balance sheet composition that has higher weightings of cash or higher weightings of loans, which those things vary for us depending on which quarter you're looking at, that's going to impact your forward NII, which shows up right below that chart is base NII. That's in part why it's lower this quarter. So that’s what we -- impacts that.

Woody Lay

Yes. Just lastly, on the mortgage finance. You noted in the slides that the deposits to loan level old sort of normalize back to where it was in the third quarter. I mean do you think the yield pop back up to that mid-2% range? Or is that a little bit aggressive next quarter?

Matt Scurlock

I think we think the yield does move up from the 1.12%. The dynamic that is greatly influenced is the self-funding ratio. So you had a 145-ish self-fund ratio this quarter. Should that move back down to 120 in Q1, which is our current expectation, you'll see that yield move up. If you think about full year, if the rate curve plays out as the market expects it to your average yield on mortgage business will still be lower in '24 than it was in '23, but the volumes should be sufficient to generate higher net interest income. So you have lower yields, but higher NII. And then to Rob's earlier comment, our focus in that business is as well as candidly all the businesses is driving additional value beyond just the loan product. And we're increasingly bringing our broker-dealer and treasury capabilities to bear within that business. So incremental NII should also result in incremental revenue elsewhere on the platform.

Operator

We now turn to Anthony Elian with JPMorgan.

Anthony Elian

Looking at Slide Eight, it looks like average noninterest-bearing declined due to mortgage finance, but then noninterest-bearing excluding mortgage finance, the gray bar at the bottom, continued to decline to about $3.6 billion in 4Q. What drove that sequentially? And do you think that the $3.6 billion average or $3.3 billion in the period represents a bottom?

Matt Scurlock

Yes. So the $3.6 billion average in the fourth quarter, Tony, matches almost exactly the third quarter end-of-period balance, which would suggest that the decline that unfortunately occurred on the last day of the quarter, it's just due to general client transactions as opposed to some sustained or potentially emerging trend. So -- but that trend of folks actively looking to reposition excess cash into higher-paying options on our platform has largely abated. So fluctuations at period end are just going to be driven by client transactions. And then if I think about -- if we think about full year '24, the double-digit growth in gross PxV that's now been sustained over the last three years. It really accelerated into the back end of this

year. We talked on the last call that generally shows up in between six and 18 months after you win the business, you should see start -- some of that begin to show up in the middle to latter half of this year. And then maybe just a last comment. I know you know this, Tony, but others on the call may not fully appreciate it. I mean our noninterest-bearing deposit base, is commercial noninterest-bearing. It's not a bunch of very small retail checking accounts. So for clients to transact at the end of a quarter, and that could cause slight fluctuations, that's in no way a surprise. So I'd say the trends we described in Q1, Q2, where folks are actively seeking higher options, that's largely abated at this point.

Anthony Elian

Understood. And for my follow-up, big-picture question on Slide Four. It's been more than three years since you provided your performance metric targets on return on average assets and return on tangible common equity. I guess, do you guys feel like you have everything in place now in terms of people, businesses, technology systems in order to achieve those targets in 2025? And is it just a matter of execution now?

Rob Holmes

It's 100% execution now. That's what's so exciting about where we are in the transformation. The risk of the build is done. We have a core competency now of taking efficiencies, improving client journeys. We have data as a service. We feel really good about the tech platform to run the bank versus change the bank. Composition of the spend. We are very focused on -- well, let's put this way. There's no additions to the platform in terms of talent or client-facing people that we need to execute the strategy. Well, that's just one component of it. I don't think you see the efficiencies abate, as Matt said, and I think he quantified them.

Operator

(Operator Instructions) We now turn to Broderick Preston with UBS.

Broderick Preston

I wanted just to clarify something, Matt, just what you said on the mortgage finance versus the static balance sheet NII sensitivity that you provide. Were you saying that the 15% pickup in mortgage activity that I think you guys typically use Moody's is projecting would be enough to offset the 4% decline in the down 100 scenario?

Matt Scurlock

No. I'm saying in the down 100 scenario, which is a bit more aggressive than what Moody's outlook would suggest you would have mortgage -- you have ample capital to support a flex up in mortgage finance volumes from your existing client base, which would generate more than enough revenue to offset that $40 million decline. So I think often times, and I totally understand why. But oftentimes, Brody, I think folks, when they think about rates, so we think about front rates. And that, of course, does impact us in terms of deposit pricing as it relates to Fed funds and on commercial loan yields as it relates to SOFR. But part of how we manage rate risk and the associated balance sheet positioning is based on the impact of longer-term rates on volumes. So it's just an important -- it's an important thing to call out. It is a limitation of that static modeling which is obviously something that's required by SEC and is presented for comparison to other banks. So we'll make sure to give you guys much detail as we can on that moving forward.

Broderick Preston

Got it. Could you help us maybe think through the impact of down 100 being more aggressive than what Moody's has outlined how that would impact the mortgage finance business, you always obviously do a lot of business in the IB there as well. So if you had a pick up above and beyond the 15% that Moody's was forecasting, how would that impact your investment banking revenue?

Rob Holmes

Yes. I'll start. I mean there's a number of different dynamics to the answer to the question. One is, as rates go down, investment banking fees will go up more transactions will take place. The clients will be doing things with the balance sheet, there will be acquisition activity, et cetera. And there'll be capital solutions opportunities. There'll be just a broad based. There will be volatility of the sales and trading floor. There's a lot of things on the fee and also invest like I said, in treasury management fees will come up because ECRs will go down. So I think we're -- we built the business to really succeed in any market rate cycle. And as we go down, we'll see an increase in an ability to take advantage of that scenario.

Matt Scurlock

I mean the 146% year-over-year growth, Brody, it's not like we are building the investment bank with a lot of economic or structural tailwinds. So I mean, in fact, there's likely headwinds against all businesses except to Rob's point, the rates business where you had to invert a curve and enable people to swap. So we're confident in our ability to drive revenue growth agnostic to the economic environment. But if you actually do see rates decline and get a bit of a tailwind, it would be nothing but beneficial.

Broderick Preston

Got it. And then I just had a couple of last ones on the mortgage finance business. Would you -- do you happen to have -- of the $5.6 billion of the average deposits you had this quarter, what portion of that is compensated via the relationship pricing?

Matt Scurlock

I think the technical term would be significant. Yes, a significant portion and that's disclosed in the deck. And as I alluded to, Brody, the portion who are compensated has increased significantly -- let me take a step back. Our ability to effectively win deposit relationships with clients to use our balance sheet for other services in the mortgage space has been really strong. And then the portion that have moved to compensated has also increased and then the associated beta has also increased as they faced a just hopefully like once in a century type decline in their volumes and ability to generate sufficient cash flow. So you've got all those -- all three of those things really pressure deposit costs. And again, different than on the commercial side, we would expect a similar beta on the way down there. We don't anticipate a material lag, if any.

Broderick Preston

Got it. And then just last one. Beyond the first quarter, Matt, would you kind of remind us how you think the average balances is for the -- for the mortgage finance loans should track? And then how the deposit to loan ratio for that business should track maybe in the second, third, and fourth quarter? I'm just trying to make sure we nail down the seasonality.

Matt Scurlock

Yes. I would use the same self-funding ratio that we experienced last year, but the volume, the full year volumes, again, based on a forward curve that can change by the minute, but the anticipated volumes are 4.7% average for the full year, and you'd start to see that ready pick up Q2 and Q3. And then implied forward curve would suggest that you see rates come down enough in the fourth quarter, where there wouldn't be as large of a third to fourth quarter decline as we've historically experienced. You have that buffered a bit by declining rate environment and increased volumes.

Operator

This concludes our Q&A. I'll now hand back to Rob Holmes, CEO, for closing remarks.

Rob Holmes

Thanks everybody, for joining the call. Have a great quarter. Look forward to talking to you in the second quarter.

Operator

Ladies and gentlemen, today's call has now concluded. We'd like to thank you for your participation. You may now disconnect your lines.