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Regions Financial Corp. (RF)

Q1 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Paula, and I'll be your operator for today's call. I would like to remind everyone that all participant phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator instructions]

I will now turn the call over to Ms. Dana Nolan to begin.

Dana W. Nolan
Head-Investor Relations

Thank you, Paula. Good morning, and welcome to Regions first quarter 2016 earnings conference call. Participating on the call are Grayson Hall, Chief Executive Officer; and David Turner, Chief Financial Officer. Other members of management, including John Turner, our Head of Corporate Banking; and Barb Godin, Chief Credit Officer, are also present and available to answer questions.

Throughout the call, we will be referencing a slide presentation. A copy of this presentation, as well as our earnings release and earnings supplement, are available under the Investor Relations section of regions.com.

Also, let me remind you that during today's call, we may make forward-looking statements, which reflect our current views with respect to future events and financial performance, and you should be mindful of the risk and uncertainties that can cause actual results to vary from expectations. These factors are described in the cautionary disclaimer regarding forward-looking statements in our earnings release and in other reports we file with the SEC.

I will now turn the call over to Grayson.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

Thank you, Dana. And good morning, and thank you, everyone, for joining our call today. First quarter's results reflect a strong start to 2016 and demonstrate that we are successfully executing our strategic plan. We are pleased by our continued progress despite a challenging and somewhat volatile economic backdrop.

For the first quarter, we reported earnings from continued operations of $257 million, and earnings per share total $0.20. These results reflect growth in total revenue, lower adjusted expenses and positive operating leverage. Importantly, we continue to deliver results in areas we believe are fundamental to future income growth by expanding our customer base as we grew checking accounts, households, credit cards and wealth accounts.

A key driver to this success is our ability to leverage our approach to relationship banking. We are pleased that once again, we've received external recognition for building a strong customer experience at Regions. This quarter, both the Temkin Group and the Greenwich Associates, recognized Regions for providing industry-leading customer experiences.

Looking at our results further and we achieved total average loan growth of 5%, compared to prior year. Consumer lending is off to a solid start, as loan balances exceed $30 billion. We have introduced new initiatives to expand our consumer product offerings, which led the year-over-year growth in consumer lending of 5%. Our new point-

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of-sale initiative within indirect lending led this growth with more loans that doubled over the prior year, exceeding our internal expectations. We do expect continued growth in this product category in 2016.

Indirect auto lending continues to grow as balances increased over 9% compared to last year. Credit card balance has increased modestly as we remained focused on expanding a number of customers that carry and utilize Regions' credit card. And we have experienced success on this front as our penetration rate of deposit customers has increased 140 basis points from one year ago, and now stands at 17.5%.

We're also focused on expanding our direct consumer lending capabilities as we recently announced an agreement with Avant. This arrangement allows us to offer additional alternatives to create stronger digital experiences for our customers and prospects. We also had an encouraging quarter in business lending. With total average loans at 4% over the prior year, all of our business lending areas, corporate banking, commercial banking and real estate banking, achieved growth over the prior year.

Total adjusted revenue increased 7% over the first quarter of 2015, reflecting effective execution on our strategic plans to grow and diversify revenue. Investments within Capital Markets are clearly demonstrating progress as Capital Markets income more than doubled versus the first quarter of 2015.

Importantly, our efficiency initiatives are allowing us to sub-fund these investments as adjusted expenses declined 2% from the previous quarter. We ended the quarter with an adjusted efficiency ratio of 60.6%, an improvement of 280 basis points compared to the fourth quarter of 2015. With respect to the current environment, we continue to expect the U.S. economy to demonstrate progress, but at a measured pace. The global and macroeconomic environment remains a concern, but we do expect modest improvement.

Low oil prices continue to create challenges for certain industry sectors while benefiting others. Consequently, we continue to closely monitor our direct energy portfolio, as well as portfolios subject to contagion. As expected, there continues to be downward migration in risk ratings. We are supporting and working closely with our customers as they take appropriate and constructive actions to lower costs, reduce debt and improve liquidity.

We do anticipate continuous stress in the sector, and we'll make appropriate adjustments. Additionally, we have established appropriate energy reserves, which now stand at 8% of our direct energy exposure. But more broadly, excluding energy and related industries, we do see continued favorable credit quality in the wholesale and consumer portfolios.

Turning to capital deployment. As you're aware, we submitted our capital plan earlier this month. We continue to deploy our capital effectively through organic growth and investing strategically in initiatives to increase revenue or reduce expenses, while we also return an appropriate amount of capital to share holders.

In closing, our solid first quarter results provide evidence that we are successfully executing our strategic plan with a continued commitment to our three primary strategic initiatives, which are grow and diversify our revenue streams, practice disciplined expense management and effectively deploy our capital. These are all integral to the successful execution of our strategic plan and we are on track to deliver our long-term performance targets.

With that, I will turn it over to Dave who cover the details for the first quarter.

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

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Thank you. And good morning, everyone. Let's get started with the balance sheet and a recap of loan growth. Average loan balances totaled $82 billion in the first quarter, up $750 million or 1% from the previous quarter. Business lending average balances increased to $51 billion, up 1% from the previous quarter and 4% over the prior year.

Commercial loans grew $373 million or 1%. It was driven by corporate banking and real estate banking. Specialized lending also contributed to loan growth, driven by new relationships and technology and defense, restaurant, as well as an increase in line utilization and energy and natural resources.

Commitments for flat linked quarter and line utilization increased 110 basis points to 47.8%, primarily driven by energy lending, which increased from 53% to 56%. Total production declined 26% from the prior quarter, and we are beginning to experience softer pipelines in some areas due to less optimistic and uncertain macroeconomic conditions. However, consumer lending had another strong quarter as almost every category experienced growth and total production increased 3%.

Average consumer loan balances were $31 billion, an increase of 1% over the prior quarter, and 5% over the prior year. Indirect auto lending increased 2% and production increased 4% during the quarter. Other indirect lending, which includes point-of-sale initiatives increased $76 million linked quarter or 15% as production increased 120%.

Now looking at the credit card portfolio, average balances increased 2% from the previous quarter, and our penetration into our existing customer base currently stands at 17.5%. Mortgage loan balances increased $75 million and total home equity balances were relatively flat, up $8 million from the previous quarter.

Let's take a look at deposits. Average deposit balances increased $262 million from the previous quarter, and increased $2 billion over the prior year. Deposit costs remained at historically low levels at 11 basis points, and total funding costs remained low at 28 basis points. With respect to deposits, we are primarily core deposit funded, with 67% of our deposits coming from consumer and wealth deposits.

Low cost deposits make up 92% of our total deposits, and approximately half of our deposits come from cities with less than 1 million people. Additionally 50% of our deposits are from customers with $250,000 or less in their account. This is why we continue to believe our deposit betas will be a competitive advantage for us as rates rise.

So let's see how this impacted our results. Net interest income and other financing income on a fully taxable basis was $883 million, up 3% from the fourth quarter. However, excluding the impact of the fourth quarter lease adjustment, net interest income and other financing income on a fully taxable equivalent basis increased $12 million or 1% for the quarter, and increased $51 million or approximately 6% compared to the prior year.

Higher loan balances and increases in short-term rates, along with the items that are unlikely to repeat, including lower premium amortization and higher dividend income related to trading assets were the primary drivers behind the linked quarter increase. This increase was partially offset by lower dividends recognized on Federal Reserve stock, higher debt interest expense and one less day in the quarter.

The resulting net interest margin for the quarter was 3.19%. Excluding the impact from the fourth quarter lease adjustments, the net interest margin increased by approximately 6 basis points. Now 5 basis points of this increase was attributable to the impact of day count during the quarter, and the previously mentioned items that are unlikely to repeat.

Total non-interest income increased 1% on an adjusted basis from the fourth quarter, driven by growth in our revenue diversification initiatives, as we successfully execute our strategies. In particular, Capital Markets income

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was strong on a linked quarter basis, up 46%. This was driven by contributions from the recently expanded mergers and acquisition advisory services group.

Additionally, revenue was bolstered by fees generated from the placement of permanent financing for real estate customers, as well as syndicated loan transactions. And due to the nature of the business and the fact that we are building out our capabilities, Capital Markets income will likely experience some movement from quarter-to-quarter. However, we are very pleased with the impact our added capabilities are producing.

Wealth Management also experienced a strong quarter despite a challenging market environment. Income was up 6% quarter-over-quarter due to higher seasonal insurance income and the impact from recent acquisitions.

Investment services income was up 7% attributable to an increase in annuity sales. However, investment management and trust fees were negatively impacted by market conditions. Seasonality and posting order changes that went into effect in early November last year impacted service charges, which declined 4% from the fourth quarter. And looking ahead, we expect modest growth in service charges as we benefit from last year's 2% checking account growth and continued account growth in 2016. In addition, seasonal declines in consumer spending drove a decline in card and ATM fees for the quarter. However, on a year-over-year basis card and ATM fees increased approximately 12%.

Other non-interest income included reductions to revenue of $12 million reflecting market decreases in relation to assets held for certain employee benefits, which is offset in salaries and benefit expense. Quarter over quarter, Mortgage revenue was up 3%. Additionally in the quarter, we purchased the rights to service of approximately $2.6 billion of mortgage loans, bringing our total residential servicing portfolio to $40 billion. And we will continue to explore and evaluate opportunities to expand our mortgage servicing portfolio.

During the quarter, we also had a $14 million increase in income related to bank owned life insurance. This was primarily attributable to claims benefits, as well as a gain on exchange of policies. And we expect the run rate going forward will be in the $18 million to $20 million quarterly range.

Let's move on to expenses. Total reported expenses in the first quarter were $869 million. And on an adjusted basis, expenses totaled $843 million, representing a decline of $18 million or 2% quarter-over-quarter as we implement our efficiency initiatives. As previously noted, in the fourth quarter of 2015, we announced plans to consolidate 29 branches as part of our strategic plan to close 100 branches to 150 branches. In the first quarter of 2016, we recorded $14 million of property-related expenses primarily related to the branch consolidation and additional occupancy optimization initiatives.

In addition, we incurred $12 million of severance expense related to staffing reductions. And excluding the impact of severance charges in the current and previous quarter, salaries and benefits decreased $9 million or 2% linked quarter. And this decrease was primarily due to a 2% reduction in staffing, as well as lower expenses attributable to market decreases in relation to asset sales for certain employee benefits that I just discussed. This was partially offset by seasonal increases in payroll taxes of $12 million, and increased incentives related to fee-based revenue growth.

Professional and legal expenses declined, primarily due to a favorable legal settlement of $7 million, which is not expected to recur going forward. FDIC fees increased $3 million from the previous quarter. And as previously disclosed, we expect the FDIC fees to increase by approximately $5 million on a quarterly basis when the FDIC assessment surcharge is implemented.

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Our adjusted efficiency ratio was 60.6% in the first quarter, driven primarily by growth in new revenue initiatives, which have been funded by expense eliminations. And our plan to become a more efficient organization is well underway.

So let's move to asset quality. Total net charge-offs decreased $10 million to $68 million and represented 34 basis points of average loans. The provision for loan losses was $113 million and our allowance for loan losses as a percent of total loans was 1.41% at the end of the quarter, which compares to 1.36% of total loans outstanding at the end of the fourth quarter. The increase in the allowance is primarily attributable to an increase in direct energy-related loan reserves. Total loan loss allowance for the energy loan portfolio was 8% at the end of the first quarter compared to 6% at the end of the fourth quarter.

Beginning primarily in the third quarter of 2015, low oil prices began to drive the migration of a number of large energy credits into criticized loans, primarily in the Exploration and Production and Oilfield services sectors. Continued low oil prices prompted further migration of some of those credits into classified loans this quarter. As a result, total business services criticized and classified loans increased $254 million, including an increase in classified loans of $703 million, and a decrease in special mention loans of $449 million.

Total non-accrual loans, excluding loans held for sale, increased $211 million from the fourth quarter. At quarter end, our loan loss allowance to non-accrual loans or coverage ratio was 116%. Additionally, troubled debt restructured loans or TDRs declined 2% from the prior quarter.

Now regarding our Energy portfolio, while oil prices remain volatile, exposures remain manageable. Should prices remain in the $30 to $45 range, we continue to expect losses in the $50 million to $75 million range in 2016. And should oil prices average $25 per barrel through the end of 2017, we would expect incremental losses in the $100 million range.

In addition, weakness in energy, mining and metals and agriculture are starting to put some pressure on certain commercial durable goods companies. However, we believe our allowance for loan losses is adequate to cover inherent losses in our loan portfolio. Given where we are in the credit cycle and fluctuating commodity prices, volatility in certain credit metrics can be expected, especially related to larger dollar commercial credits.

Let's move on to capital and liquidity. During the first quarter, we returned $255 million to shareholders, including the repurchase of $175 million of common stock and $80 million in dividends. Under Basel III, the Tier 1 ratio was estimated at 11.6% and the Common Equity Tier 1 ratio was estimated at 10.9%. On a fully phased-in basis, Common Equity Tier 1 was estimated at 10.7%, well above current regulatory minimums.

So, let me provide an overview of our current expectations for the remainder of 2016, which remain consistent with those we delivered at our investor day last fall, and also on our earnings call on January. We expect total loans to grow 3% to 5% on an average basis relative to fourth quarter 2015 average balances. Given current softer market conditions in the Commercial space, we could track towards the lower end of that range.

Regarding deposits, we continue to expect average deposit growth in the 2% to 4% range, compared to the fourth quarter of 2015 average balances. Now, commensurate with loan growth projections, we expect net interest income and other financing income to increase 2% to 4% on a full-year basis. Should we experience no additional rate increases, we expect to be at the lower end of that range. In addition, the higher end of the range is more challenging due to the lower dividends on the Federal Reserve stock.

Now with respect to the net interest margin, we will likely experience modest pressure if rates remain low. However, further increases in short-term rates will serve to stabilize the margin. As a result of our investments, we

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continue to grow adjusted non-interest income and therefore expect that in the 4% to 6% range on a full-year basis.

We will continue to make investments in 2016, however, our plan to eliminate $300 million of core expenses is underway and we expect to achieve 35% to 45% of that number in 2016. Therefore, we expect total adjusted non-interest expenses in 2016 to be flat to up modestly from the level in 2015. We expect to achieve a full-year adjusted efficiency ratio less than 63% and positive operating – positive adjusted operating leverage in the 2% to 4% range in 2016.

We also continue to expect net charge-offs in the 25 basis point to 35 basis point range, however, given the volatility and uncertainty in the energy sector, we would expect to be at the top end of that range this year.

In closing, the first quarter was a strong start to the year and we are encouraged by our results. The investments made in 2015 and before positioned us well for 2016 and beyond. And we look forward to updating you on our progress throughout the year as we continue to build sustainable franchise value.

With that, we thank you for your time and attention this morning. And I'll turn it back over to Dana for instructions on the Q&A portion of the call.

Dana W. Nolan
Head-Investor Relations

Thanks, David. Before we begin the Q&A session of the call, we ask that you please limit your questions to one primary and one follow-up, in order to accommodate as many participants as possible this morning. We will now open the line for questions.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for your questions. [Operator Instructions] Your first question comes from Michael Rose of Raymond James.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning, Michael.

Michael Rose
Raymond James & Associates, Inc.

Q

Hey. Good morning, guys. How are you?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Doing very well, Michael. Thank you.

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Doing great.

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Michael Rose
Raymond James & Associates, Inc.

Q

Good. Maybe we can just start on the Energy portfolio, can you give us a sense for kind of how much – how far are you through the kind of the spring borrowing base redetermination? I assume you're just kind of in the earlier stages. And now that we've seen the redundant oil, I mean, how confident would you be if oil sit around these levels that you might come in closer to the lower end of your kind of charge-off range for the year of $50 million to $75 million related to Energy? Thanks.

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Michael, it's Barb Godin. I'll go ahead and answer the question in terms of our spring redetermination. We're roughly 25% of the way through and so far to date, we've seen roughly 20 – perhaps 25% reduction in the borrowing base is our expectation. And in terms of the guidance that we've given relative to charge-offs for the rest of the year, again we've run our models, we feel very good about where our numbers are. We do still anticipate that there'll be volatility in the oil prices and again that's the reason that we're looking at $25 a barrel over the next two years, which would again create $100 million of incremental loss we think next year and $50 million to $75 million this year.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

And Michael, we're continuously working with our customers and monitoring their financial situations as they're trying to rationalize their expenses, their spending base as well as trying to restructure their capital base. Obviously we saw stability of oil prices at this level, it would be a benefit to those customers but as we go through our credit analysis, we aren't making that assumption. We continue to stress our portfolio to what we think the possibilities to volatility are. And so if it turns out to be stable at a higher point then I think that's a good day for our customers and a good day for us. But we aren't necessarily trying to anticipate it in our credit review process.

Michael Rose
Raymond James & Associates, Inc.

Q

Okay. That's helpful. And then maybe as a follow-up, it looks like the unfunded commitments were down about $150 million quarter-to-quarter. Are you guys actually trying to grow new credits at this point? And where should we expect maybe that unfunded balance to close out over the next year or so? Thanks.

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Again, Michael, this is Barb. If you look at the unfunded balance, you're right, it was down $165 million. A lot of that was paid down at the lines, there were a handful of draws that we saw, not that many, and there was a little bit of new business. It was primarily in our Midstream section. Midstream continues to perform well and even in the down industry there are some very good customers out there and the credits that we put on the books those are, four are credits, three of them in fact which are existing relationships, we knew those customers very well. One was a new customer that we've been courting for a while. Very pleased with the quality of the credit that we've [ph] drawn (27:30). We don't see a lot of additional credit, but again we will continue to look for opportunities in the segment if they present themselves and if they meet our credit quality guidelines.

Michael Rose
Raymond James & Associates, Inc.

Q

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And Barbara, if you could just comment on the level of unfunded – I mean, level of commitments year-over-year and where we see that going forward?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Certainly. We started January of 2015 with commitments at $6.9 billion and we right now sit at $4.8 billion. So we've come down a fair bit on commitments. If I do the same comparison for you on outstandings, those outstandings went from $3.3 billion down to $2.7 billion in that same timeframe. So again, as we think about utilization, what happens as you know is as we do our borrowing base redetermination, that reduces our outstanding commitments, and just as a general rule of thumb for every $100 million that we reduce in our commitments, that will naturally just favor [ph] to what math (28:27), increase our utilization rate by 85 basis points.

Michael Rose
Raymond James & Associates, Inc.

Q

Okay. That's really helpful. And maybe just one follow-up for you, David, just to clarify, I think you said if there is no more rate increases this year, that you would expect it to be at the lower end of the NII guidance, is that – do I hear that correctly?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

That's correct.

Michael Rose
Raymond James & Associates, Inc.

Q

Okay. Thanks for taking my questions.

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Thank you.

Operator: Your next question comes from Bill Carcache of Nomura.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning, Bill.

Bill Carcache
Nomura Securities International, Inc.

Q

Hey, good morning. Thank you for taking my question. I wanted to follow up on some of your – the comments you just made. Can you share with us, what kind of utilization rate assumption is implicit in your current allowance and the methodology that gets you comfortable with that?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

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Yeah, we don't really use a utilization rate per se, what drives our allowance is our risk rating process. The risk rating process takes into account all the information that we know about the customer, what's going on in the industry, looking at their financials deeply. And again, yes, we do refer to what they would have, for example, in their borrowing base, what our petroleum engineers say about it. So again, we don't have a specific number that we use. What I can tell you about the draws and the utilization is, as we look at the Energy and Production customers, the E&P customers, again they're governed by a borrowing base. So, we see some natural ability for draws not to happen there.

And then as we look at our Oilfield Services customers, we have a number of covenants, a number of leverage covenants that are there. We also have anti-cash hoarding provisions that we have been putting in for the last several months, as accounts have been coming up for renewal. So again, that will naturally reduce their ability to draw on those lines.

Bill Carcache
Nomura Securities International, Inc.

Q

I see. That's helpful. So, under the stress scenario that you guys lay out, where you show that if oil prices average $25 a barrel through 2017, the expectation that that will result in an additional $100 million of charge-offs, in that kind of stressed environment, it would seem that there may be more draws on existing unfunded lines, but I was trying to understand to what extent that, that was being captured in the methodology. But it sounds like – the increase in drives under stress scenarios is not something that is captured. Maybe if you could just give a little bit of commentary on that?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Yeah. There's a difference between how we reserve and how we do our stress testing. And on our stress testing, we're actually looking at our entire committed book, and reviewing that and applying all the various stresses against the committed book.

Bill Carcache
Nomura Securities International, Inc.

Q

Okay. Thank you very much.

Operator: Your next question comes from Paul Miller of FBR and Company.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning, Paul.

Tim Hayes
FBR Capital Markets & Co.

Q

Hey guys, this is Tim Hayes for Paul Miller. First off, in regard to your Avant relationship, where is the annual originations trending there and where exactly on the balance sheet are those loans being [ph] housed (31:40)?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

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So we – as you've seen we have invested in a number of digital partnerships to try to improve our offerings to customers, predominantly consumers and small businesses in the digital space. We have announced a partnership with Avant, that partnership while communicated will not launch until third quarter. So we have not provided any forecast of revenues and originations to the market at this date.

Tim Hayes
FBR Capital Markets & Co.

Q

Understood. And then you had just mentioned that in borrowing any type of interest rate hike this year that you'll stay at the low end of your NII guidance. Where do you see NIM tracking barring any hikes? Is it – are you able to sustain the current level you're at now or do you see any type of deterioration?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Yeah. Thanks. So we had a couple of things in the quarter on my prepared comment, [ph] day count (32:47) the end piece of that. We had some things won't repeat. So we said five points for that, really are things that you won't see going forward.

After that, if rates continue to stay where they are right now, we will see our net interest margin continuing to decline. So we do need some rate lift to stabilize net interest margin. As most of us in the industry have been focusing on NII growth, it's really the guidance that we've given you that 2% to 4% that we think is more meaningful but margins will come under pressure if rates stay here.

Tim Hayes
FBR Capital Markets & Co.

Q

Understood that. Thanks for the color.

Operator: Your next question comes from Christopher Marinac of FIG Partners.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

[ph] Good morning (33:38).

Christopher William Marinac
FIG Partners LLC

Q

Thanks. Good morning. I want to go back to the Energy commitments and I was curious if the pace of the decline in the commitments could accelerate just naturally as the business flows through the rest of the year?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Again, it's Barb. And again if you do just a back-of-the-envelop and assume that 25% reduction in the borrowing basis, again, that would naturally translate into roughly $1.2 billion in reduction on existing commitments, taking them down from 4.8% somewhere down to the 4.5%, 4.6% range full-year, it will reduce.

Christopher William Marinac
FIG Partners LLC

Q

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Okay. And then Barb, is the ongoing SNC exam going to influence how the criticized numbers come out or have we seen a lot of that change already this last quarter?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Yeah. We have fully incorporated the Shared National Credit exam into our results this quarter.

Christopher William Marinac
FIG Partners LLC

Q

Okay. Very good. Thank you.

Operator: Your next question comes from David Eads of UBS.

David Eads
UBS Securities LLC

Q

Hi, good morning. You made some comments at the beginning about seeing a little bit of softness in – on the Commercial side in terms of demand for loans. I'm just curious if you've flushed that out a little bit, and – is that related, you also talked about some pressure on some of the ancillary energy companies. So, is it related to those type of companies or more broad-based, and are there any specific areas where you're seeing some softening loan demand?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

I think if you look at what we've started seeing in the fourth quarter and certainly carrying into the first quarter, while we've seen good growth in balances in our wholesale book and our consumer book, we have seen some softness in demand when you look at our sales pipelines for wholesale credits.

Clearly the industry segments that are energy-related are energy-dependent, in particular metals, minings and assorted commodities, those industry segments obviously are very soft, but we've seen the general slowdown or softness if you will in wholesale credit demand. We don't know if that is a sustainable trend or whether that's sort of a first-quarter anomaly, but at this point in time we're just signaling that we see demand just a little softer, still very competitive market and we're still able to find ways to serve our customers and extend credit, we feel good about our level of engagement with our customers, that I think given the market volatility since the first of the year, we're just seeing customers be a little bit more reserved if they will in terms of accessing credit facilities.

David Eads
UBS Securities LLC

Q

All right. Thanks. And then maybe just I'm curious if you have any color on – you got the final DOL fiduciary rule, if that's going to have any real impact on your Wealth Management business? I'm just curious whether – how that interaction kind of plays.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Well, I mean, I think it's a great question and one that, as the rule has come out, our teams are working on. But I think the positive news is we've been working under a fiduciary model in our Wealth Management group for a very, very long time. We're very familiar with the fiduciary model and comfortable with it. We feel like we know

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how to operate in that environment. We do think that given the rules, we've got a year to implement rules as they're proposed and – and our teams are working closely with that. But given the history and the makeup of our book, we think it's a very manageable process for us.

David Eads
UBS Securities LLC

Q

All right. Thanks.

Operator: Your next question comes from Stephen Scouten of Sandler O'Neill.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Hey, guys, good morning.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

A question for you on the – kind of efficiency ratio and the continued operating leverage. I mean, obviously, you had a great quarter here in 1Q, and well-positioned for the rest of the year. But can you kind of give me some thoughts about the – on sub-63% guidance relative to how you're already at the kind of 60.6% level today? And what the trends might look like?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Yeah, it's a great question. So, we want to send the guidance back to the – just under 63% as we shared with you before because we're continuing to also make investments to grow revenue. There's timing differences that can get in our numbers. If you read our supplement carefully, you'll see there's some timing differences there as well. We are very pleased with the progress we've made on controlling our expenses in this first quarter and see that continuing throughout the year, and frankly for years to come as we have our $300 million expense program.

But remember the point of that is not just in the – to improve efficiency. It's really to make room for the investments we want to make to continue to grow and diversify our revenue stream and you'll see – you'll see continued investments there, there are some new things like our M&A advisory group that just come on board in the fourth quarter. And they had a pretty solid first quarter as we've mentioned. We expect that to continue to grow, and you'll see their revenue growth, but you'll see expenses associated with that business continuing to grow as well. So, we think it is more appropriate to go back to the 63% or the less – efficiency ratio versus leveraging the 60.6%.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Okay. That makes a lot of sense. Thanks. And then maybe, one follow-up on the NIM conversation, so if I understand it properly, we're kind of using maybe 3.14% as a real starting point as we look into the subsequent

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quarters. And I know you're trying to focus more on NII, but as I look at that NIM, I mean, do you think that could be a two basis points to three basis points a quarter kind of compression if ex-higher rates?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Yeah. I think, so your start point's fair. So there are five points in there that we want to reset down from 3.19% to your 3.14% number. And there it's really kind of rate-dependent. I think if we stay at low rates, you'll see that coming down some. If you see – you get an increase, maybe that stabilizes a bit. So, I think you'll have margin pressure unless we get to move – get a move sometime in 2016.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Great. Thanks so much. I appreciate it.

Operator: Your next question comes from John Pancari of Evercore ISI.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning, John.

John Pancari
Evercore ISI

Q

Good morning. On the cost that you gave around the NIM this quarter and some of those items, on the premium am, I just wanted – if you can clarify that the tenure was down through the quarter and so – and mortgage rates saw a little bit of that. So how do you actually see lower premium am, I would think it would be higher?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Well, it's a little bit of – John, it's Dave, there's a little bit of a lag effect there. You're right. We actually saw the other way our premium amortization was a little lower in the first quarter than it had been in the fourth quarter to the tune of about $5 million. And that's as we see the tenure drop, you would expect more activity coming through the second quarter and more premium amortization and that's part of what we are trying to signal that won't recur from an NII standpoint. So, you have $5 million to $7 million roughly of NII benefit in the first quarter, all things being equal that you won't see in the second quarter.

John Pancari
Evercore ISI

Q

Okay. All right, that's helpful. All right. And then secondly, the – on the loan loss reserve for Energy, I know you gave us the direct Energy reserve of – now it's 8% versus 6% before. What is the Energy reserve for the total Energy book? So, direct Energy and the indirect, what is the reserve for that because you give us the criticized for that, but not the reserve?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

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Yeah, and we don't reserve it that way. Again, they fall into different categories. So, as we look at both the individual customers, et cetera, they roll up differently. Don't have that detail. But, remember that the reserve that we have in total is available to absorb all loan losses, irrespective of if they are in Energy or not.

John Pancari Q
Evercore ISI

Okay. All right. And then lastly, on expenses, just want to see if I can get a little more color on the comp expense. This quarter came in lower than expected and just want to see if you can give us some color on the outlook there? Thanks.

David J. Turner, Jr. A
Chief Financial Officer & Senior Executive Vice President

Yeah. So, our comp expense was down, even though we had payroll taxes. There are some things that as I mentioned, we're continuing to make investments and I do think that we have our merit increases that happened kind of mid-quarter. We have – our certain incentive grants that are long-term grants that start in the second quarter, that you'll see expenses coming through on that too. So, I think that we are off to a good start. We're down 538 fulltime equivalents, start to finish in the quarter. You'll see some run on benefit because those all have been happened January the 1st. But you should see us – you'll see that tick up a bit even though we have payroll tax benefit that won't repeat. We do have some investments and what I mentioned on the compensation increases that will come through in the second and later quarters.

John Pancari Q
Evercore ISI

Okay. And then related to that – sorry, one more thing just around, I want to get your updated thoughts on operating leverage for the full year given your NIM expectation and spread revenue expectation that you just mentioned, but also what you just said here around expenses where they're trending?

David J. Turner, Jr. A
Chief Financial Officer & Senior Executive Vice President

Yes. So we're guiding you to 2% to 4% operating leverage. I think if rates stay flat and we have NII close to that 2% or the lower end of the range. That's a big driver of our operating leverage. And so you would expect to be at the lower range on operating leverage. We feel pretty confident that we'll be within that. I know we're well ahead of that range in this first quarter. But we think it's more appropriate to guide you towards the 2% to 4%.

John Pancari Q
Evercore ISI

Okay. Great. Thanks, David.

David J. Turner, Jr. A
Chief Financial Officer & Senior Executive Vice President

Yeah.

Operator: Your next question comes from Matt O'Connor of Deutsche Bank.

O. B. Grayson Hall A
Chairman, President & Chief Executive Officer

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Good morning, Matt.

Q

Hi. This is [ph] Rob (44:48) from Matt's team. I was just curious how – have you guys disclosed how much Energy charge-offs were this quarter? Did you guys take any?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Yes. This is Barb again, we had no Energy charge-offs this quarter.

Q

Okay. So as we think about the $50 million to $75 million of losses for the rest of the year, any additional granularity you can give around, yes, what segments you expect those losses to come from and timing of those losses?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Yeah. I would primarily see the losses coming from by and large, the Oilfield Services segment. The E&P segment, we know our collateral is, it doesn't go bad on us. Not like it's bananas in a truck that we have to worry about. And again these are customers that we've worked with for a long time. And so we're going to continue to work with those customers. Some of the Oilfield Services customers are getting pressure, getting squeezed as the E&P customers reduce their CapEx, reduce their cost structure, so that's where we see it coming from.

Q

Got you. And just secondly, I was wondering if you can give an update on credit trends you're seeing in the Energy-heavy markets, Texas, Houston, Louisiana?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

Yeah. In general in terms of what we're seeing there, I'll start with Texas. Texas and in particular Houston is pretty well-diversified. We got some information as to how it all breaks out in the supplement as well for the four Gulf states. But we're seeing good things in Texas still, things aren't robust as they were, but they're not doing badly.

On the consumer front, we're really not seeing much. We are actually looking at all of our consumer portfolios in our Customer Assistance Program in particular to see, are any customers calling relative to being dislocated from their employment or having an issue because they are either in the energy sector or things such as restaurants. If we go to a restaurant and the restaurant's business has slowed down because people in the energy sector are not going as often.

We have seen virtually things are stable. Since beginning of the year, we've had 39 customers across all of our states call in, saying that they are somehow tied to the energy sector and that they are looking for some customer assistance and those primarily around the auto sector. And again, that is up probably maybe 1% over what we would normally have seen.

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Q

Okay. Thanks.

Operator: Your next question comes from Ryan Nash of Goldman Sachs.

Ryan M. Nash
Goldman Sachs & Co.

Q

Good morning, guys. Maybe I can follow up a little bit on the last question. Barb you talked geographically, but I just wanted to ask a little bit of the questions you said early about seeing contagion out of metals and mining and agriculture putting some pressure on durable good companies, and can you just help us understand how big a portfolio that is and if we don't see a pickup in oil, are you expecting to actually see losses in some of these portfolios? Or is it more that you're seeing negative migration?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

So, yeah, thanks for the question. Firstly, in total the metals and mining is about an $800 million portfolio; with durable goods about $110 million and primary metals just under $500 million, $480 million. And we're seeing some pressure in terms of migration into other asset classes – or, sorry risk-weighting classes. And again that's tied some of it to Energy, and as I think of the customers who build specifically, manufacture the pipelines, some of those customers clearly have reduced demand.

Of course you've got the pressure because of the strong U.S. dollar and the pressure of what's going on in places like China. So we do see more of that migrating over into the [ph] non-pass rated (48:46) categories, again our sense around losses on that still comes back to our overall range of 25 basis points to 35 basis points for the year and that would incorporate the views on that. Our Ag portfolio is roughly $800 million as well. We're primarily in raw crops and what we see there again is pressure on those commodities, again given what's going on globally.

Ryan M. Nash
Goldman Sachs & Co.

Q

Got it. David, maybe can I ask a question on the non-interest income. And if I look in the first quarter, you're growing at about a 10% clip on an annual basis, and I was just wondering, given the fact how strong it's been and the fact that – you're now articulating service charges likely going to be up over for the year given customer growth, could we actually see non-interest income growing at the high end or maybe even a little bit above again, just given the fact that you've done acquisitions, the customer growth is coming in very strong, and there hasn't been, there doesn't seem to be that many headwinds in terms of the fee income?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Yeah, I think, Ryan that we have a shot of being at the high end of that. I would caution you to extrapolate [ph] now (49:55) what you're seeing for the full year. I'd like to say we could get above the 6%, but we're going to guide to the 4% to 6% right now because there are certain things. Capital markets revenues have a tendency to move around a bit, just depends on when transactions get closed. So you could see that move somewhat.

Mortgage is susceptible to the rate environment as we see. But we feel good, the second, third quarters are always strong quarters in Mortgage, so we feel good there. But you have things like from a trust standpoint, it's continued

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a little bit on where the market goes. So, and of course, we had the bank-owned life insurance. I think we carved that out, that's not going to recur. So I think that we feel good about the investments that we made. We feel good about the performance of those investments. But we need, this is one quarter, we need to get a few more under our belt before we can call it above the 6%.

Ryan M. Nash
Goldman Sachs & Co.

Q

Got it. If I can just squeeze in one last quick one. If I look at capital payout, it was almost 100% this quarter, clearly the stock is trading at or below tangible book value, so I appreciate you wanting to be tactical. But can we continue to return capital at this kind of pace and as you think out over the next couple of quarters assuming if the stock continues to trade in this range, you think we could get more aggressive from the 2015 CCAR level?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Well, as we think – so we've made our submission, we can't talk specifically about what's in it. But I think if you look at our capital, where we are today from a capital ratio standpoint was an expectation over time that we could expect to move our Common Equity Tier 1 to that 9.5% range. The question is what pace will we have to get there. So if you just think about our payout being in the mid-90s last year and growing our loan portfolio 5% let's just call it $4 billion for easy math, that's about 40 basis points of capital. So, we're doing right now, we'll continue to get our capital ratio down. And for us, we want to make appropriate investments, we understand we're trading below tangible book value, it's a pretty investment to buy your shares back, which is why we've been doing what we're doing.

And you should continue to expect that we have an appropriate return to our shareholders, although our focus really is to use our capital for organic growth. Our capital is to be used to expand our business, to grow new revenue, to make investments in technology and process improvement and of course pay an appropriate dividend to our shareholders. And then after that, if there's excess capital on earnings then it's repurchasing shares from our shareholder, which is what we did last year and you should expect that same approach this year.

Ryan M. Nash
Goldman Sachs & Co.

Q

Thanks for taking my questions and great quarter.

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Sure.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: Your next question comes from Jennifer Demba of SunTrust.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning, Jennifer.

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Jennifer Demba
SunTrust Robinson Humphrey, Inc.

Q

Good morning. You guys just covered my question. Thank you.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: Your next question comes from Geoffrey Elliott of Autonomous Research.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Hi, Geoffrey.

Geoffrey Elliott
Autonomous Research LLP

Q

Hello. Thank you for taking the question. On the Capital Markets business, can you give us a bit more color on what drove that doubling in revenues from last year, what the areas are, where you've been making investments and how much you think you can continue to grow the business?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Yeah. Geoffrey, so we made a number of investments over the past couple of years. And the most recent one was our M&A advisory firm that we acquired in the fourth quarter last year. They really are just getting going. So they had a little bit of activity in the first quarter that was nice to see. We expect that business to continue to ramp up and grow over time. We had made investments to get a license under the Fannie Mae DUS program for placement of real estate loans. And we had a good quarter there as well. Loan syndication, we built that out a bit by hiring Stifle and that continue to benefit us. So Capital Markets had a very good quarter. And as I mentioned earlier is that can move around on you from quarter to quarter. So what we see from those investments, we're very encouraged about.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

I mean, Geoffrey, that's a momentum business. We're very pleased with how they performed this quarter. We obviously feel like we've invested a lot in people and product and technology in that space and – but today at this point, earnings in that business can move around from quarter-to-quarter, but we believe we're on a very positive trajectory and we continue to look for opportunities to make more investments in that part of our business. And so we anticipate over time it becoming more and more important to our franchise.

Geoffrey Elliott
Autonomous Research LLP

Q

And thinking out longer-term, what are the sort of capabilities that you might like to add to that business?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

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Well, I think what we want to be careful of is not get ahead of ourselves too much. We've made quite a few investments in Capital Markets and really have brought on some very talented people. And I think our focus is to continue to execute and grow what we just discussed.

And I think the purpose of expanding our Capital Markets is in – for two primary reasons. One, we want to grow and diversify our revenue and this gives us a chance to grow non-interest revenue. But maybe the most important component of that is, we want to be able to bring the entire Regions to our customer, to be able to help our customer to succeed, so we've made investments in capabilities that we think can do that.

We didn't have – our Capital Markets business had been part of Morgan Keegan for a lot of years and when we disposed of that, we disposed of the capital markets opportunity, so we're having to rebuild that and we've made investments to do it by acquiring the talent that we need to have, and we want to be careful not to go too fast. And like I said, we're encouraged by where we are.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Yeah. And just to be clear, our focus is on a debt capital markets platform. David mentioned Morgan Keegan, there were a number of things that we used to do that we know [ph] is hard to (56:50) do, but I would say that as we think about building out that debt capital markets platform with the focus on meeting customer needs, other capabilities are fixed income, sales and trading.

Today, we participate in fixed income underwritings, we'd like to lead those opportunities. Just as our syndication's revenue is growing, as we win more lead roles, we want to be able to lead those fixed income underwrites as well. So, that's one capability we don't have today, we'll have hopefully in the near future. Low Income Housing Tax Credit is a really good business for us.

We'd like to have some syndication capabilities, as we think about building out our origination and distribution model. And so, we see a lot of upside in capital markets and debt capital markets revenue over time. But, we will be thoughtful in that regard. We're trying to diversify our revenues across a wide spectrum of services for our customers. And to David's point, the most important part is to build capability to service our customers.

Geoffrey Elliott
Autonomous Research LLP

Q

Great. Thank you.

Operator: Your next question comes from Marty Mosby of Vining Sparks.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Hey, Marty. Good morning.

Marty Mosby
Vining Sparks IBG LP

Q

Good morning. I wanted to kind of go on the other side of the Capital Markets equation, which is as you saw the uptick in the revenues, typically that business has a corresponding uptick in expenses, which would accentuate the drop that you saw this particular quarter. So just wanted to kind of see, if there was any other way that you're approaching it, or was that already embedded in the expense number we saw this quarter?

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O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

No. I mean, Marty, what we said all long is we really are trying to focus on expense initiatives so that not only can we improve the overall financial performance of the company and create positive operating leverage, but we also want to do it in a way that allows us to make investments we need to make in other parts of our business.

And as David mentioned a moment ago, we had a substantial reduction in workforce over the last quarter. That's helped us mitigate a lot of the expense growth, but at the same time make some of these investments. And all I ask John Turner to expand and give a little more color on Capital Markets and what the expenses there may owe.

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

Yeah, I would just say, recognizing that our primary investment is in people and people with a significant skill set, and so to your point there is cost associated with that. I think we are trying to be very thoughtful about the businesses that we enter and the returns that we get in those businesses, making sure that while we're fairly compensating our associates, we're also earning fair return for our shareholders as well. And to Grayson's point, in order to make those investments, we've got to reduce expenses elsewhere, which we've been successful doing thus far.

Marty Mosby
Vining Sparks IBG LP

Q

David, when you said lower expenses associated with liabilities on employee benefits, was that the BOLI impact, or was there something else maybe in the pension plan that you've made adjustments to that you might have a sustainable benefit going forward? And can you put a little number around that, if that is that?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

Yeah, that's – so Marty, if you go back, I had mentioned that non-interest revenue income was down because the chart-related trading assets associated with certain of our benefit plans. Offset to that was your expense you're talking about. So it's virtually a one-for-one. It's in that $10 million or $12 million range.

Marty Mosby
Vining Sparks IBG LP

Q

Thanks.

Operator: Your next question comes from Chris Mutascio of KBW.

Christopher Mutascio
Keefe, Bruyette & Woods, Inc.

Q

Good morning. Thanks for taking my question.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Thank you.

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Christopher Mutascio
Keefe, Bruyette & Woods, Inc.
Q

Hey, David, I just got some follow ups. I just want to clarify a couple of things, make sure I have it right. The dollar amount of the – I won't call them non-recurring, but the things you mentioned that benefited net interest income in the quarter, was that the $5 million to $7 million, I think, when you're discussing premium amortization or was it higher than that including the dividend income from the trading assets?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President
A

It's both. The $5 million to $7 million takes both of those. It's $4 million to $5 million on premium amortization, another $2 million to $3 million on the dividend.

Christopher Mutascio
Keefe, Bruyette & Woods, Inc.
Q

Okay. I kind of backed into it thinking that was the total amount of the two when I look at the margin.

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President
A

Right.

Christopher Mutascio
Keefe, Bruyette & Woods, Inc.
Q

The second thing, just to clarify, and I think I have this right, too. So you're resetting the kind of bar, if you will, for second quarter for those things on the margin, so instead of $319 million maybe you're looking at an adjusted $314 million. But any type of margin compression due to the lack of rising interest rates would be off of the resetting $314 million number, not the $319 million number?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President
A

That's correct.

Christopher Mutascio
Keefe, Bruyette & Woods, Inc.
Q

Okay. Great. Thanks for the clarification.

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President
A

You bet.

Operator: Your next question comes from Gerard Cassidy of RBC Capital Markets.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer
A

Good morning, Gerard.

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Gerard Cassidy
RBC Capital Markets LLC

Q

Can you hear me now? Hello?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

I can. I can now.

Gerard Cassidy
RBC Capital Markets LLC

Q

Thank you. Okay, great. Thank you, guys. Can you guys share with us what you're seeing in spreads on your corporate loan book, or have they – some of the banks have reported that they seemed to be stabilizing. Are you guys seeing that in the C&I portfolio or the commercial real estate mortgage portfolio?

John Turner
Senior Executive Vice President-Head of Corporate Banking Group, Regions Financial Corp.

A

Gerard, this is John Turner. We are seeing stabilization in pricing. Still a very competitive market, and I would say we're competing more on tenure and structure than we are on price. It has been nice to see some stabilization in pricing over the last quarter or two.

Gerard Cassidy
RBC Capital Markets LLC

Q

Very good. And then in regards – I just want to go back. I think you guys mentioned about the special mention loans coming down as the energy portfolio has migrated to different classes, was the drop in special mentioned entirely energy or were there some others that caused that number to decline?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

It's Barb, again. Pretty broad based decline. In fact, if you look at our delinquencies, 30-day delinquencies were down, 90-days delinquencies were down. And [ph] action (01:03:27), what we did in energy, all of our other credit metrics would be down as well including our reserve. We would not have built as much reserve. We may have even had a small release had it not been for us providing for energy.

Gerard Cassidy
RBC Capital Markets LLC

Q

I see. And where the actions you've taken in energy this quarter as a result of the Shared National Credit exam, as well as your own internal observations of what's going on with the portfolio?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

As we mentioned, we did incorporate the Shared National Credit exam. But again, we're looking at these credits on a daily, weekly, monthly basis. We're in constant contact with our customers. Our portfolio is very granular. Between Oilfield services and the E&P customers, there's less than 80 customers in total. So we're staying in constant contact with them, working with them and get a real understanding of what's going on with them. And that's one of the reasons that we've moved credits into various classifications as we collect that information from them.

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Gerard Cassidy
RBC Capital Markets LLC

Q

Great. And then just last question, and I apologize if you've addressed this already. In terms of the loans that went into non-performing status, the energy loans, what percentage of those loans were part of syndicated credits for you or a participant, versus loans that you may have originated on your own?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

That would be the majority of them. I don't have an exact percentage for you, but it would be the majority of them.

Gerard Cassidy
RBC Capital Markets LLC

Q

Okay. I appreciate it. Thank you, guys.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: Your next question comes from Peter Winter of Sterne Agee.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning, Peter.

Peter Winter
Sterne Agee

Q

Good morning. When I look at the balance sheet, it tends to be more levered to the long-end of the curve than most of your peers. And with the tenure really coming down so much during the quarter, I'm just wondering if the tenure were to move back up, would that help stabilize the margin? And then secondly is there anything you can do in terms of like remixing the balance sheet to be a little bit more reliant on the shorter-end of the curve?

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President

A

So you're exactly right. If you look at our sensitivity, our sensitivity is more so to the backend, to the long-end and then the short-end. And as tenure does pick back up, then you would see that manifest itself in two ways: one, better reinvestment rates; and two, lower premium amortization. And we're forecasting our premium amortization to go up because of the reduction in the tenure but that could be short lived, as you know, very volatile. And we're positioned exactly where we want to be. It was intentional and we think it was right thing to do for us.

Peter Winter
Sterne Agee

Q

Okay. And then just one quick follow-up. On the loan portfolio, commercial real-estate, the owner occupied, that continues to decline, and I'm just wondering if there is light at the end of the tunnel where it starts to flatten out, maybe even get a little bit growth going forward?

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O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Yes. I mean, if you look at our loan portfolio, almost every category is now growing, and the vast majority of the markets we operate in or showing net loan growth. But one lending segment that's been slow to demonstrate growth has been the only occupied space, which is predominantly small- to medium-size businesses, and a lot of that is an amortizing portfolio they choose to expand plant and equipment.

We've still not seen that small business owner return to the market with courage to invest and expand. We keep thinking, we'll reach a pivot point in that business. Production is remarkably strong in that part of the business over the last couple of quarters, but outstandings on a net basis has still continued to decline. We still think our expectations are that it'll pivot at some point, but we still think we're ways away from that.

Peter Winter
Sterne Agee

Q

Got it. Thanks. Very good quarter.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Thank you.

Operator: Your next question comes from Jason Harbes of Wells Fargo.

Jason E. Harbes
Wells Fargo Securities LLC

Q

Hey. Good morning, guys. Most of my questions have been asked and answered, but just wanted to follow up on the coverage ratio guidance I think you guys gave back at the Investor Day. You said 120 basis points to 140 basis points is about the right range. This quarter pretty much at the high-end of the range with the energy-related reserve build. Just wanted to get a feel for, is that still the kind of the right way we should be thinking about in light of some of the mix shift with the greater focus on card and some of the other peer-to-peer lending activity?

Barbara I. Godin
Chief Credit Officer & Senior Executive VP, Regions Financial Corp.

A

It's Barb. And again, that's 120 basis points to 140 basis points that we touched on back then. That's just a general rule of thumb. You're going to see some of our peer companies go lower than that and some go higher than that, so there is no specific sweet spot that we're looking for. We're letting our process play out each quarter. And yes, we did go to the higher end, a little over a $140 million this time. But again, that'll be different each quarter as we take in all the information that we have.

Jason E. Harbes
Wells Fargo Securities LLC

Q

Okay. Thank you very much.

Operator: Your next question comes from the Jack Micenko of Susquehanna.

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O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Good morning.

Jack Micenko
Susquehanna Financial Group LLLP

Q

Hi, good morning. Hi there. Most of my questions have been answered, but wanted to just ask about auto. It's been a bright spot for the portfolio, have grown nicely. Have you made any changes there around underwriting of product type with some of the concerns that have sort of cropped up at the lower end of the market? And then, I guess, secondly, do you think if SAR is down something modestly next year you can continue to grow that portfolio?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Well, I mean, I think it's been a very good – as you say, it's been a good growth market for us and we've shown some fairly good growth rates, albeit from a fairly low level of outstandings that we had in the balance sheet as a business we re-entered a few years ago. We have continued to adjust our credit underwriting standards on that business over time as we've seen the market change. We try to stay very rigorous and disciplined in that regard. We have modified some of our adjustments to try to reduce the duration of the portfolio. We've made some adjustments there to try to narrow the part of the market that we're willing to lend into.

I think that our actions have, to a certain degree, throttled the amount of volume that we get. But volume that we're getting is of a quality that we feel good about, and the performance that we see is strong. I'd just remind you that we only deal with preferred dealers. We don't participate in the sub-prime market to any great extent, and we do not have any leasing products. So we feel we're pretty plain and simple in how we approach the auto market and trying to stay disciplined in how we participate. I do think...

Jack Micenko
Susquehanna Financial Group LLLP

Q

Okay. Thank you.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

I do think the latter part of your question is – depending on what sales volumes are for that industry, it would clearly drive what opportunities we have for origination growth.

Jack Micenko
Susquehanna Financial Group LLLP

Q

Okay, fair enough. Thank you.

Operator: Your next question comes from Jesus Bueno of Compass Point.

Jesus Bueno
Compass Point Research & Trading LLC

Q

Hi to everyone. Thank you...

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O. B. Grayson Hall
Chairman, President & Chief Executive Officer
A

Good morning.

Jesus Bueno
Compass Point Research & Trading LLC
Q

... for taking my questions. Very quickly, you touched on small business lending. Do you have any update on the Foundation partnership and perhaps how they did in the – now you have one kind of full quarter of that, and perhaps even expectations for this year?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer
A

Yeah. I would say it's still too early to call. We're pleased with the early results of that partnership. We've not publicly released any of those performance metrics. But I would say that while we're pleased, it's still too early for us to make any sort of public announcement on where we think that's going. And it's still a relatively small contributor to our origination. You'll see us doing a number of these innovative partnerships. In aggregate, they should be very meaningful, but on an individual basis they are all incremental.

Jesus Bueno
Compass Point Research & Trading LLC
Q

Great. Got it, thank you. And just – again on the reserve build for energy this quarter, approximately how much of that kind of 2% increase in the energy reserve was directly related to the results of this SNC exam, and would you say primarily the whole thing or a large portion of it?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer
A

Well again, as Barb Godin had said earlier, we're not going to comment directly on that exam. But what we'll tell you in general is that we use all input that we get, both internally and externally, in talking to our customers. And all of the input we've got and from all sources have been accounted for in how we reserve this quarter.

Jesus Bueno
Compass Point Research & Trading LLC
Q

Fair enough. And I'll just slip one more in. On Mortgages, quickly, I guess the volumes were pretty solid this quarter and look to be better than, I guess, what was anticipated. I guess, how do you feel kind of the first few weeks of the second quarter? I guess, going into this quarter, how are your pipelines, and I guess have you also had any lingering effects from TRID still in the first quarter and anticipating that for the second quarter?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer
A

Well, I would tell you, first quarter, we're very encouraged by how the fundamentals of the company are performing. We're seeing good solid results across most all of our businesses and most all of our geographies. And so if you look at the fundamentals of the company and how we performed, we think we had a good solid quarter.

We do have some headwinds in the energy portfolio and metals and mining, and we're addressing those in a very rigorous and disciplined manner. But on a net basis, we feel pretty good about it and we think that the fundamentals performance that we're seeing in the first quarter should continue into the second quarter.

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As we mentioned earlier, we have seen a softness in our sales pipelines in the first quarter, which should make second quarter a little more uncertain than we'd like. But I would tell you that we continue to be encouraged by the progress we're making. We don't think there's been any impact of TRID at this point in time, and don't anticipate that in the second quarter. But continuing to make progress. And as David said earlier, if you look at our Mortgage business, in particular, second quarter and third quarters always seasonally the best quarters we have of the year. And so we do anticipate second quarter being better in that regard.

Jesus Bueno
Compass Point Research & Trading LLC **Q**

Great. I appreciate the color. Congrats in the quarter, and thanks for taking my questions.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer **A**

Thank you. Thank you. I believe – have we got more questions?

Operator: We have one more question. Your final question comes from Jill Shea of Credit Suisse.

Jill Shea
Credit Suisse Securities (USA) LLC (Broker) **Q**

Good morning.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer **A**

Good morning.

Jill Shea
Credit Suisse Securities (USA) LLC (Broker) **Q**

Just on the deposit service fees, they held up quite well in the quarter just given seasonality and the full quarter impact of the posting order changes. Can you just talk about the underlying account growth momentum you're seeing, and sort of how that ties into that outlook for a fee growth going forward?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer **A**

Yeah. [ph] Will do. (01:16:02)

David J. Turner, Jr.
Chief Financial Officer & Senior Executive Vice President **A**

So as I mentioned in the prepared comments, we actually have grown checking accounts last year about 2%. We're growing checking accounts this year. And we have our full quarter of service charges from the posting order impact that started November last year. So we kind of got a mid-quarter last quarter, full quarter this quarter, and we think we're off to seeing service charges increase modestly as we go throughout 2016. A big driver of that is our ability to grow customer accounts, both last year and this year.

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O. B. Grayson Hall
Chairman, President & Chief Executive Officer

A

Yeah. And I would tell you the account growth has been very steady and very solid and broad across our franchise footprint. Really encouraging is that consumers continue to build liquidity. We're seeing very strong liquidity metrics on the consumer side. And we're also seeing the number of active cards. Both debit cards and credit cards, number of active cards are up, as well as the number of transactions for cards are up.

I would comment that credit card balances are up modestly. It's usually a seasonal time of the year, but we saw average credit card balances up 2% to 3%. We're probably up 8% year-over-year, but that's in the face of strong double-digit transaction activity on cards. But customers are being fiscally conservative. And we're not seeing balances go up remarkably, but we are seeing them go up modestly. But transaction activity is very strong and so we're encouraged.

Jill Shea
Credit Suisse Securities (USA) LLC (Broker)

Q

Great. Thanks.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer

Well, if that's the last question, we appreciate everyone attending our call today. And we thank you for your time and attention, and we look forward to seeing you next quarter.

Thank you.

Operator: Thank you. This concludes today's conference call. You may now disconnect.

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