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Regions Financial Corp. (RF)

Q1 2017 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

Executive Vice President - Head of Investor Relations, Regions Financial Corp.

Thank you, Paula. Good morning and welcome to Regions' first quarter 2017 earnings conference call. Participating on the call are Grayson Hall, Chief Executive Office; and David Turner, Chief Financial Officer. Other members of senior management are also present and available to answer questions. A copy of the slide presentation referenced throughout this call, as well as our earnings release and earnings supplement, are available under the Investor Relations section at regions.com.

I'd also like to caution you that we will make forward-looking statements during today's call that are subject to risk and uncertainties, and we'll also refer to non-GAAP financial measures. Factors that may cause actual results to differ materially from expectations, as well as GAAP to non-GAAP reconciliations, are detailed in our SEC filings.

I will now turn the call over to Grayson.

O. B. Grayson Hall

Chairman, President & Chief Executive Officer, Regions Financial Corp.

Thank you, Dana, and good morning. Thank you for joining our call today. I'll review highlights for our first quarter year-over-year financial performance, and then David will take you through the details compared for the prior quarter. Let me begin by saying that we're pleased with our first quarter results which highlight our continued focus on effectively managing expenses and strengthening of our asset-sensitive balance sheet.

For the quarter, we reported earnings available to common shareholders from continuing operations of $278 million, an 8% increase over the first quarter of prior year. Earnings per share were $0.23, representing a 15% increase over the prior year. Importantly, by expanding our customer base, we continue to deliver results in areas we believe are fundamental to future income growth as evidenced by growth in checking accounts, households, credit cards, and wealth management relationships.

Taxable equivalent net interest income and other financing income was stable year-over-year as interest rate increases offset the impact of lower average loan balances. And the resulting net interest margin was 3.25%, an increase of 6 basis points. Non-interest expenses remained well controlled of less than 1% year-over-year as our efficiency efforts helped mitigate core expense inflation and the impact of investments and new initiatives.

As it relates to loan growth, we are encouraged by conversations with our customers. Moreover, consumer and small business sentiment continues to improve. In addition, customers particularly in the middle market segment are beginning to plan for future capital expenditures. However, this optimism is yet to translate into the confidence needed to take on additional debt today. For now, customers appear to be in more of a wait and see mode.

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In the near term, our asset-sensitive balance sheet positions us to grow net interest income even in the absence of loan growth aided in part by the strength of our deposit franchise. We will continue to work closely with our clients to meet their financial needs, while also maintaining a disciplined focus on expense management and appropriate risk-adjusted returns. Year-over-year average loans decreased $1.3 billion as growth in consumer lending portfolio was more than offset declines in the business lending portfolio. The overall health of the consumer remained strong, as we experienced solid demand, and steady loan growth in almost all consumer loan categories.

Average consumer loans grew by $719 million or 2% from the first quarter of the prior year. Average business lending balances declined $2.1 billion or 4% driven by our continued focus on achieving appropriate risk-adjusted returns, the de-risking of certain portfolios and asset classes and an ongoing softness in demand for middle-market commercial and small business loan. We are optimistic that loan growth will improve as the year progresses, but remain committed to prudently growing loans without compromising our risk or return requirements.

With respect to asset quality, we continue to characterize overall credit quality as stable. Our energy portfolio is performing as expected and there are no emerging concerns. However, given the current phase of the credit cycle, volatility, and certain credit metrics can be expected, especially as it relates to large-dollar commercial credits.

Turning to capital deployment, we remain committed to managing capital towards our long-term targets, that includes effectively deploying our capital through organic growth and strategic investments to increase revenue or reduce ongoing expenses, while also returning an appropriate amount of capital to our shareholders.

Over the course of several years, we've developed a robust capital planning process to ensure we have sufficient capital levels to withstand a variety of stress scenarios. We continue to focus on effective capital deployment and have submitted our CCAR plan in line with this initiative.

We look forward to discussing the details of that plan with you next quarter. Our commitment is superior customer service also remains a top priority, and we are pleased Regions which was recently recognized as the highest rated bank in the U.S. in customer experience by the Temkin Group. Moreover, Regions was the fourth highest rated company across all industries. Our teams remain focused on providing outstanding service, as well as solid financial advice, guidance and education to help our customers to reach their financial goals.

In summary, our first quarter performance reflects a solid start to 2017, and we look forward to building on this foundation in the remainder of the year.

With that, I'll turn it over to David to cover the details of the first quarter. David?

David J. Turner

Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

Thank you, Grayson, and good morning, everyone. Let's get started with the balance sheet and look at average loans. In the first quarter, average loan balances totaled $80.2 billion, down $411 million from the previous quarter. Average balances in the consumer lending portfolio decreased $215 million, driven by the company's decision to exit a third-party arrangement within the indirect vehicle portfolio, as well as the sale of affordable housing residential mortgage loans at the end of 2016.

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Excluding these items, average consumer loans would have increased approximately $140 million in the first quarter. Average third-party indirect vehicle balances declined $186 million or 9% during the quarter. And we expect this portfolio to decline between $500 million and $600 million on average during 2017. Excluding the third party indirect vehicle portfolio, average indirect vehicle balances increased $33 million.

Average mortgage balances decreased $16 million during the quarter. However, excluding the impact of the fourth quarter affordable housing, residential mortgage loan sale of $171 million, average balances increased approximately 1%. We expect mortgage production to hold up relatively well despite the rising rate environment.

This is due in part to Regions' mortgage production mix being more heavily weighted to purchase at approximately 70%. In addition, we recently enhanced our capabilities within our online home loan direct mortgage channel. And although it is a relatively small portion of total mortgage production today, we're encouraged by the recent results which are up 41% year-over-year.

Average home equity balances decreased $105 million as customers continue to pay off equity line of credit balances faster than new production. Average home equity lines of credit decreased $184 million, while average home equity loans increased $79 million. And we continue to experience success with our other indirect lending portfolio, which includes point-of-sale initiatives. This portfolio increased $48 million or 5% linked quarter.

Average balances in our consumer credit card portfolio increased $20 million or 2%. Penetration into our existing deposit customer base increased to 18.6%, an improvement of 20 basis points compared to the prior quarter and 110 basis points year-over-year.

Turning to business lending, average balances decreased $196 million as declines in owner-occupied commercial real estate and investor real estate were partially offset by growth in commercial and industrial loans. As Grayson mentioned, customer optimism has yet to translate into balance sheet growth. The linked quarter decline in average balances was primarily due to our continued focus on achieving appropriate balance and diversity, while also improving risk-adjusted returns.

The company experienced modest growth in average commercial industrial loans, led by growth in government and institutional banking and increased utilization within real estate investment trust. However, we continue to reduce exposure due to concerns about increased risk in certain industries and asset classes.

Average direct energy loans decreased $93 million or 4% during the quarter and ended the quarter at 2.5% of total loans outstanding. In addition, average multi-family loans decreased $147 million or 8% compared to the fourth quarter. Further, softness in demand and competition for middle market and small business loans continues to impact loan production.

While headwinds to the growth remain, we are experiencing success through improved overall returns. And the company continues to expect business lending growth in 2017, driven in part by growth in technology and defense, healthcare, power and utilities and asset-based lending portfolios.

Let's take a look at deposits. Total average deposits decreased $530 million from the previous quarter and average low-cost deposits decreased $173 million. Total average deposits in the consumer segment increased $605 million or 1% in the quarter. This growth reflects the unique strength of our retail franchise and overall health of the consumer.

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Average corporate segment deposits decreased $565 million or 2% during the quarter, impacted by seasonal declines. Average deposits in the wealth management segment declined $204 million or 2% during the quarter, as a result of ongoing strategic reductions of collateralized deposits. Certain institutional and corporate trust customer deposits, which require collateralization by securities, continue to shift out of deposits and into other fee income-producing customer investments.

Average deposits in the other segment decreased $366 million or 9%, driven by the strategic decision to reduce approximately $500 million of higher cost retail brokered sweep deposits that were no longer a necessary component of our current funding strategy.

Deposit costs remained near historically low levels at 14 basis points, and total funding costs remain low, totaling 32 basis points in the quarter. It's important to point out that our deposit base is more heavily weighted towards retail customers. Approximately 74% of average interest-bearing deposits and 52% of average interest free deposits are considered retail.

In addition, we have a loyal customer base as more than 40% of our consumer low-cost deposits have been deposit customers at Regions for more than 10 years. And, finally, approximately 50% of our deposits come from MSAs with less than 1 million people and approximately 35% from MSAs with less than 500,000 people. Both are in the top quartile versus our peer group. For these reasons, we believe that our deposit base is a key component of our franchise value, and will serve as a competitive advantage in a rising rate environment. So let's see how this impacted our results.

Net interest income and other financing income, on a fully taxable basis, was $881 million in the first quarter, an increase of $7 million or 1% from the fourth quarter. The resulting net interest margin was 3.25%, an increase of 9 basis points. Both net interest margin and net interest income and other financing income benefited from several factors during the quarter, including higher interest rates and lower premium amortization on investment securities, partially offset by lower average loan balances and modestly higher deposit cost.

The modest increase in deposit cost is primarily attributable to indexed deposits, which make up approximately 6% of interest-bearing deposits. In addition, two fewer days in the quarter negatively impacted net interest income and other financing income by approximately $10 million, but benefited net interest margin by approximately 2 basis points.

Premium amortization on mortgage-related securities declined to $38 million from $43 million during the quarter. And if interest rates remain at current levels or rise further, we would expect to benefit from additional declines, ultimately achieving a quarterly amortization run rate in the low to mid-$30 million range in 2017. Looking forward to second quarter, we expect net interest margin to expand by an additional 3 basis points to 5 basis points in spite of the negative impact from one additional day.

Non-interest income decreased $12 million or 2% in the quarter, primarily due to a $5 million gain associated with the sale of affordable housing mortgage loans and a $5 million gain from the sale of securities recorded in the prior quarter that did not repeat. Adjusted non-interest income decreased $2 million in the quarter.

Wealth management income increased $6 million or 6%, primarily due to seasonal increases in both interest and investment services income. Card and ATM fees increased $1 million or 1% due to an increase in interchange income. Checking account growth helped to offset seasonally weaker service charges, which declined $5 million or 3%.

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Mortgage income decreased $2 million or 5%, driven by lower production related to seasonality and rising interest rates. Consistent with our strategy to further increase the mortgage servicing portfolio, during the quarter, the company reached an agreement to purchase the rights to service approximately $2.9 billion of mortgage loans mortgage loans with an expected close date of April 30.

Including this transaction, the company will have purchased the rights to service more than $15 billion of mortgage loans over the past four years. Increased revenue for mortgage servicing is expected to help offset the impact of lower mortgage production.

Capital markets income increased $1 million or 3% during the quarter, as increased revenues associated with debt underwriting and loan syndications were partially offset by lower merger and acquisition advisory services. Looking forward, we expect capital markets revenue to improve throughout the remainder of the year and expect the first quarter's adjusted non-interest income to represent the low point for the year.

Let's move on to the expenses. Total non-interest expenses decreased 2% during the quarter. On an adjusted basis, expenses totaled $872 million, $5 million less than the prior quarter, reflecting our continued commitment to disciplined expense management. Total salaries and benefits increased $6 million. Seasonal increases in payroll taxes were partially offset by declines in production based incentives, while staffing levels remained relatively unchanged.

Professional and legal expenses decreased $4 million during the quarter, primarily due to lower litigation related costs. Net occupancy expense decreased $4 million as the fourth quarter included elevated charges related to flood damaged branches, while the first quarter included interest recoveries related to branch damages in prior periods. Other real estate expenses, included within our other non-interest expense category also decreased $4 million during the quarter.

Looking at second quarter, salaries and benefits are expected to increase, as a result of merit and the issuance of long-term incentive awards. In addition, increases in certain non-interest income categories will drive related increases in production base incentives. However, our outlook for adjusted non-interest expenses for 2017 is unchanged, as we continue to expect a year-over-year increase between zero and 1%. The first quarter adjusted efficiency ratio improved 50 basis points to 62.7% and the effective tax rate improved 80 basis points to 30.4%.

Let's take a look at asset quality. Net charge-off totaled $100 million in the first quarter, an increase of $17 million and represented 51 basis points of average loans. The current quarter included the impact of three large dollar commercial credit charge-offs, totaling approximately $39 million. However, much of these large dollar commercial credits were already included in our reserve estimates. This combined with improvement in other credits means that the provision for loan losses was $30 million less than net charge-offs and our allowance for loan losses as of percentage of total loans decreased 3 basis points to 1.33%.

The allowance for loan and lease losses associated with the direct energy portfolio decreased to 6.1% in the quarter compared to 7% in the fourth quarter as our exposure to direct energy continue to decline and the overall portfolio continues to stabilize. Total non-accrual loans, excluding loans held for sale, increased $9 million or 2 basis points to 1.26% of loans outstanding driven by increases in non-energy commercial loans.

Total business services criticized loans decreased 2%, and total delinquencies decreased 16%. The improvement in criticized loans was primarily due to declines in energy and energy related credits. The decline in total delinquencies was driven by improvement in consumer loan categories. Allowance for loan losses as a

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percentage of total non-accrual loans or coverage ratio was 106% at quarter end. Excluding energy, the coverage ratio decreased from 138% to 135% in the first quarter.

Total direct energy charge-offs, including the large commercial credit charge-off were $13 million this quarter. Given current market conditions, our expectation for additional energy related losses during the remainder of 2017 remains unchanged at $27 million or less. Regarding overall asset quality, we continue to view core credit metrics is stable, and although we experienced elevated charge-offs during the quarter associated with larger dollar commercial credits, our expectations for full year charge-offs of 35 basis points to 50 basis points remains unchanged.

Let's move onto capital liquidity. During the quarter, we repurchased $150 million or 10.2 million shares of common stock, and declared $78 million in dividends to common shareholders, resulting in 80% of earnings returned to shareholders. At the same time, our capital ratios remain robust. Under Basel III, the Tier 1 capital ratio was estimated at 12.1% and the Common Equity Tier 1 ratio was estimated at 11.3%. Now, on a fully phased-in basis, Common Equity Tier 1 was estimated at 11.2%, and we were also fully compliant with a liquidity coverage ratio as of quarter end. And finally, our liquidity position remains solid with the historically low loan-to-deposit ratio of 80%.

So, in terms of our expectations for the remainder of 2017, with respect to loan growth, several risk management decisions impacted our first quarter average balances, including declines in energy, multi-family and third-party indirect vehicle portfolios, as well as a strategic affordable housing mortgage loan sale in the fourth quarter of last year. Excluding these decisions, we would have reported average loan growth of approximately $200 million for the quarter.

So, looking ahead, we expect to modestly grow average loans on a sequential linked quarter basis throughout the rest of 2017 and on an ending basis, we expect to grow approximately 2% for the remainder of the year and excluding the impact of our third-party indirect vehicle portfolio, we now expect full-year average loans to be approximately flat with the prior year.

Regarding deposits, we now expect full-year average balances to be relatively stable with the prior year as continued consumer deposit growth is expected to offset the strategic reduction of certain collateralized and broker deposits. In spite of the revision to average loan growth, the improvement in market interest rates allows us to revise expectations for net interest income and other financing income growth upward to 3% to 5%.

Regarding non-interest income growth, due to a weaker start to 2017, we are revising downward our expectation for adjusted non-interest income growth to 1% to 3%. Total adjusted non-interest expenses in 2017 are still expected to increase between 0% and 1%. And we remain committed to achieving a full-year adjusted efficiency ratio of approximately 62% with positive adjusted operating leverage in the 2% to 4% range. Additionally, we continue to expect a full-year effective tax rate in the 30% to 32% range, and expectations for full-year net charge-offs remain in the 35 basis point to 50 basis point range.

So in summary, while there are several puts and takes this quarter, it's important to point out that our total revenue growth, expenses, efficiency and operating leverage expectations remain essentially unchanged despite lower balance sheet growth assumptions as we continue to focus on profitability and returns.

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.

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Dana W. Nolan
Executive Vice President - Head of Investor Relations, Regions Financial Corp.

Thank you, David. Before we begin the Q&A, as a courtesy to others, please limit your questions to one primary question and one follow-up to accommodate as many participants as possible. We will now open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question comes from Ken Usdin of Jefferies.

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

A

Good morning.

Ken Usdin
Analyst, Jefferies LLC

Q

Thanks. Good morning. Hey, David, I was just wondering when you talked about your NIM expectations for the second quarter, can you talk a little bit about the betas that you're expecting underneath that and the impact from premium am that you expect to kind of help as that lags forward as well?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Sure, Ken. So, we believe that we're going to continue to have some benefit from premium amortization coming in a little lower. We're down about $5 million this quarter and expect that to continue to drift down until we get to that $30 million range where we think it stabilizes. As we think about NIM expectations and betas, we have baked in our beginning beta at about 40%, so there is a little upside opportunity. Our beta thus far has been less than 10%, but vast majority of that was driven by the index deposits that we talked about, about 6% of interest-bearing deposit.

So, if our beta comes in a little better than we forecast, maybe we can outperform. We do have kind of baked in for the remainder of the year about a hike-and-a-half baked in for this year with that 40% beta in our guidance that we've just given you. So if we get rate increases quicker, if we get a steeping in the yield curve, those would benefit us above the guidance that we've given you.

Ken Usdin
Analyst, Jefferies LLC

Q

Okay, great. And then just as follow-up to that, so given that you have been in part purposely reducing some of the auto loans and you still have to see this year loan runoff, how much of keeping a low beta is just the fact that loan growth is somewhat purposely quiet for you guys? And so just in terms of that push and pull between behavioral out there versus your need for excess deposits given that the balance sheets remain pretty stable.

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

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Well, we've had historically won the lowest loan deposit ratios and it really speaks to our ability to attract low cost deposit on the retail franchise and the stickiness of our deposit base. What we've done is we clearly want all the good low cost deposits we can get. We would like to have a more robust demand for loan growth, but we're not going to force it. We're going to take what the market is going to give us and we've made some strategic choices in terms of where we want to grow loans and we've looked at different categories that I mentioned, that Grayson's mentioned to be very careful.

So we clearly have the funding to the extent that the economy picks up in the second half of the year, which we hope and expect, but we have good core funding that can take advantage of those opportunities. And we think we'll keep our deposit beta down partly because of loan deposit ratio, partly because of our deposit makeup and the less sensitivity of our deposit franchise to price increases, which is why we think we can have expanding margin continuing.

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

A

Well, we've had very stable loan to deposits even though behind the scenes we've really been changing the composition of our deposit base quite materially. Every quarter the composition of our deposit base has got more favorable. And to David's point, we've made a lot of tactical and several strategic decisions about how we build that composition of deposits and so I think it puts us in a very unique position as we go forward.

To David's point, we don't have the loan demand we'd love to have today. That does take an awful lot of pressure off of deposit pricing, so we can be more thoughtful and disciplined in that regard, but really the composition of our deposit base is probably the most compelling argument for how we perform.

Ken Usdin
Analyst, Jefferies LLC

Q

Understood. Thanks.

Operator: Your next question comes from Peter Winter of Wedbush Securities.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

Good morning.

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

A

Good morning.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

I was just wondering, on the fee income, if I look at fee income last year it was very strong, and I'm just wondering can you talk about some of the puts and takes of the weaker guidance this year?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

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Yeah, thanks, Peter. So from an NIR standpoint, we've made a lot of investments over the years. Last year, a lot of those were coming to fruition from the investments we've made the year before. So the growth rate was necessarily going to be higher last year and even our guidance at the beginning of the year was lower because of that phenomenon. Clearly, some of the businesses that we've gotten into have more volatility than other streams and we're okay with that, because we're seeking the diversification that's important to us and we're also seeking to have those products and services that fulfill a need of a customer.

In this particular quarter, our capital markets showed a little bit of volatility to the downside and in particular in our M&A advisory service, which now we believe will grow from here. It just takes time, the pipeline to get emptied out. It takes time to rebuild those. So we feel comfortable with that. I would say in the fixed income space, March was a much better month than January and February was. There was more activity there. And so, we expect that to continue to grow.

And we're really proud of our folks in mortgage. Obviously, the first quarter is seasonally low, but done a great job because of being a purchase shop there and the strength of the roughly $8 billion of mortgage servicing we bought last year coming through. They just do a great job in servicing – low-cost servicing, and we're proud of that growth. So that and checking account growth and customer growth has really helped us to bolster NIR. So we did revise guidance down, but feel very good about where we are and we think it will pickup. We guided that this was the low watermark for the year.

Peter J. Winter
Analyst, Wedbush Securities, Inc.
Q

Okay. And just a quick follow-up. On the 10-year Treasury, in the expectations page, you're showing the 10-year Treasury at 2.48% and the 10-year Treasury right now is lower. If it continues to move lower, would that that put pressure on the net interest income to come in more towards the lower end of your range?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Well, clearly, if you stayed here or kept going lower, you would ultimately have some pressure in terms of prepayments coming in and premium amortization not declining at the pace that I mentioned. We think we're well-positioned. We have about 40% of our sensitivity on the back end. We believe we're well-positioned in particular as the Fed's balance sheet comes under scrutiny towards the end of the year. And we just think there's going to be ultimately upwards pressure, but we still think our guidance is – we had enough confidence to give an increase in the guidance that we just shared with you.

Peter J. Winter
Analyst, Wedbush Securities, Inc.
Q

Great. Thanks very much.

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

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

Good morning, Marty.

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Marty Mosby
Analyst, Vining Sparks IBG LP

Good morning. I've got more of a long-term strategic kind of question. On slide 10, you talk about your capital liquidity kind of ratios. You are more than fully compliant with any regulatory requirement that you have. Capital ratios continue to ebb up and your loan-to-deposit ratio continues to go down. Is there a chance in the future strategically to address these excesses that are on your balance sheet that need to be deployed to get your returns higher?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

So, Marty, it's a great question. So I'll start with capital and come back to liquidity. But, yeah, from a capital standpoint, we clearly have given the Street our guidance that we believe our Common Equity Tier 1 ratio target of 9.5% is right for us based on the risk in our balance sheet today.

We know to get it to 9.5%. You have to get it deployed appropriately. We seek to do that through organic loan growth, properly priced with the proper returns on it. We didn't deploy that capital into bolt-on acquisitions. And you've seen a number of acquisitions over the years, including the mortgage servicing right deal that we did last year, a series of deals and the one we're going to close next – or at the end of this month. And we also want to have an appropriate dividend to pay to our shareholders.

And then outside of that, to the extent we continue to accrete capital, we want to work our capital ratios down, returning it to our shareholders. The last year, we returned a 105% of our earnings to our shareholders. We can't tell you what our CCAR request is this year, but given what I just said, one would expect a fairly robust return to our shareholders this year. And that over time is important to us to get towards to that 9.5%, because we still are expecting to have a return on tangible common in 2018 between 12% and 14%.

And in order to do that, we have to get the denominator down to that, approaching 9.5%. So that's capital. From a loan and deposit standpoint, we'd like to have a loan/deposit ratio perhaps in that low-90 range would be a sweet spot. And we're working hard to grow loans, but we are going to force it, as I mentioned earlier. We're going to grow loans when we have the opportunity to do that, and calling efforts are ongoing.

And also, on the deposit side, we've looked at certain deposits that either we're punitive in LCR or they weren't providing liquidity such as a collateralized deposit where we might not have had a full relationship and we're letting those deposits go. So that's why if you just looked at deposit growth, you can see it declining in part. Those are strategic choices that we're making to unload those deposits that really don't provide much benefit to us.

Marty Mosby
Analyst, Vining Sparks IBG LP

My worry is that, what we're seeing is growing mortgage servicing, which is a low return business when you're just looking at allocating to it capital. When you have capital there and you put it on, it generates better returns because you're just utilizing excess capital. You also are, over the last two kind of credit cycles, the large-dollar corporates is what kind of jumped out and we're seeing that again this quarter. And when you blink about organically in your markets given the appropriate pricing and credit underwriting you have, there's a real catch between being able to organically build or fill these buckets and really being able to eventually get a lot of this trapped capital and then utilize some of this liquidity and pushing that back to the shareholders.

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So I know it's a struggle, but some of these decisions that are being forced upon you because of the situation you're in are causing some of these events or things or decisions to be made that may be affecting things differently down the road.

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Well, they are, Marty. But again, we know it's harder today in a competitive environment to grow the kinds of loans that we want to grow. But this is when it requires discipline, and we're going to stay disciplined with regards to capital allocation to organic growth. And, as I mentioned, some of the choices we've made outside of those we actually are growing.

So we're seeing opportunities to put the capital to work. And, frankly, we don't have the qualitative aspects of CCAR and we know how much capital we need to have to run our business. So we do have an avenue to deal with that excess common equity more specifically and returning it to shareholders that we didn't have before. So, in time, we can get the capital base to the right level.

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

A

Yeah. And, Marty, this is Grayson. I mean, to David's point, we've got to take the market for what it is and take advantage where opportunities present themselves, but the operating environment has got some challenges, but it's also got tremendous upside if some things go the way we hope. That being said, we've been very rigorous and very disciplined about how we're managing our balance sheet.

We think we've made tremendous progress on both loans and deposits in terms of how we have built our balance sheet over the last several quarters. We're trying to take advantage of what the market will give us, but not to force it. And we do think that in this sort of slow-growth, low-rate environment that we have to be thoughtful about it.

That being said, we're seeing a lot of optimism on the part of our business customers. It's encouraging, but it is not yet resulted in the kind of demand for bank credit that we'd like to see. That being said, tremendous amount of liquidity in the market and we've seen a lot of our customers access public debt market. And so, we do think over time that bank credit demand becomes stronger.

I'll ask John Turner to sort of speak to that for just a moment to give you a better perspective of what we're seeing in customers' markets.

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

A

Thank you, Grayson. As we've talked about before, our customers are clearly more optimistic, but I would say not confident. They're cautious. We are seeing a little improvement in our pipeline. I would say our pipelines are growing a bit. They're okay relative to where we like them to be. We look back on and we talk about choices we've made and the impact that's had on us, our objective is to create a more predictable, more sustainable, more consistent revenue base and performance and we've been very focused on de-risking on risk adjusted returns.

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So, as I look at our lost business or the opportunities that we had to grow, in 2016, we looked at over $44 billion in credit. We won about $14 billion or roughly a third, that means that of the $28 billion that we did win, over half of that was because we were not satisfied with the pricing or some other structural element.

That same momentum or same sort of paradigm has continued into 2017. We looked at over $10 billion in credit through the first quarter. We won a little over a third and of the business we didn't win, again, about 55% of that was a result of pricing or returns, or some other structural element. The point being, we can change our risk appetite and grow loans, but we're very committed to creating a culture that is focused on risk adjusted returns and that will create more predictability, more consistency. I think that's going to payoff in the long run.

O. B. Grayson Hall
Chairman, President & Chief Executive Officer, Regions Financial Corp. — A

Thank you, John.

Marty Mosby
Analyst, Vining Sparks IBG LP — Q

Thanks. Those are tough decisions and that you're working through.

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

O. B. Grayson Hall
Chairman, President & Chief Executive Officer, Regions Financial Corp. — A

Good morning.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc. — Q

Thank you. Just curious about, I know you guys have a small commercial real estate portfolio in retail and shopping centers. I was just wondering if you could give us some details around that composition as it stands as of now?

O. B. Grayson Hall
Chairman, President & Chief Executive Officer, Regions Financial Corp. — A

I think Barb Godin, our Chief Credit Officer could respond to that question, please?

Barbara I. Godin
Chief Credit Officer & Senior Executive Vice President, Regions Financial Corp. — A

Good morning, Jennifer. Thank you, Grayson. Yeah, we currently have roughly $2.6 billion in our commercial real estate retail. Another comment though, just general comment on the retail sector, is what we're seeing is in retail where they have very good shopping centers, very well placed, there's hardly any vacancy rates and then in others, there is a just a ton of vacancy rates where you're not appropriately placed. So we are watching that sector very closely. We still feel okay about that sector, the bankruptcies that we've heard about and the issues we've heard about in that area.

We have an applied market research group that actually spends a ton of their time looking at retail and retail shopping centers. Those bankruptcies were not unexpected. In general, we weren't involved in any of those, and again a lot of those chains that closed were because they were poorly placed.

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

A

Grayson, I just might add to that. Jennifer, this is John Turner. Of the $2.6 billion in exposure, roughly $1.5 billion in outstandings I should say, is in our REIT portfolio, where we largely are doing business with a small number of investment grade names. The balance or just about $1.1 billion is in our income property finance group and that outstanding level has been fairly consistent now for four quarters or five quarters, that exposure is fairly widely distributed, the largest, I guess, tenant would be grocery anchored, and most of it is basic needs, condo of anchors. And so while we have a little mall exposure in the REIT book and less in income property finance, I'd say, generally, it is a very diversified portfolio, and the one we feel pretty good about.

On the commercial side, we also have a nice sized retail book, that portfolio again is very diverse. Our largest asset class is to automotive retailers. So think of companies like Pep Boys or AutoZone something like that and largely administered through our asset based lending or Regions' business capital platform. Thank you.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Barb, would you see these areas as something you'd want to reduce over time or just kind of watching it for a while here?

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

A

We are watching it. Again, we have concentration limits on everything. It's nowhere near that concentration limit on these two pieces, so we feel fine about where is that.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thank you.

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

Ryan M. Nash
Analyst, Goldman Sachs & Co.

Q

Hey. Good afternoon, guys. I wanted to follow up on a question that Marty had asked just regarding delivering the 12% to 14% ROTC. David, you talked about, you need to get towards the 9.5% CET1, do you think, you can – given what's happening with the balance sheet, do you think you can get there organically with loan growth and capital return or do you think we would need to see some strategic activity over the next two years in order to manage the capital base down?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Ryan, it's a great question. So we can approach that 9.5%. We can't quite get to 9.5% by 2018, right after that – shortly after that we can, but we'll approach it close enough to help us to get to that 12% to 14% return, and we'll do that through primarily focusing on those two things, organic growth and some bolt-on acquisitions that have been fairly small to-date, and capital returns to the shareholders.

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Ryan M. Nash
Analyst, Goldman Sachs & Co.

Q

Got it. Grayson, if I can ask a bigger picture question, the banks have done a lot over the last few years to improve its credibility with the investor community. You guys did a great job delivering last year. When I look at today, we're obviously making some changes to the outlook. While NII is better, that's obviously rate driven, so it's not necessarily client driven. And I take the point that you guys are doing this with the mind on ret urn, so if loans are shrinking, fees are coming in lower, was there any thought towards taking another crack at expenses? I know you're cutting $400 million or at least saying given the slightly weaker top line outlook, are we going to hold expenses flat or maybe flat to modestly down?

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

A

Yeah. I mean, great question and I would say you that as we look at the first quarter, first quarter loan demand was softer than we had anticipated it would be a couple of quarters ago and so we've had to adjust our thinking to a little bit slower loan growth environment. We've never really tempered our focus on expense management. We've stayed dedicated to that throughout this process and continue to do so. We took a very aggressive stance on expenses and have delivered on that. You should expect to continue to see our resolve on that issue. From a sustainability standpoint, we do have to find ways to grow long term, but until those opportunities come about then we have to continue to stay focused on being as efficient as possible from an expense standpoint. And so, you should not see us back down from that at all.

Ryan M. Nash
Analyst, Goldman Sachs & Co.

Q

Thanks for taking my question.

Operator: Your next question comes from the Steve Moss of FBR.

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

A

Good morning.

Steve Moss
Analyst, FBR Capital Markets & Co.

Q

Hi, good morning. Following up on expenses, I was just wondering here, you had another good quarter with regard to total expenses. Does your guidance here not going to the low end reflect continued investment or other factors in terms of expectations around improved business activity later in the year?

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

A

Yeah. I mean, I think where we [ph] wound (51:05) forecast of interest expense is, we do at this point in time anticipate stronger growth opportunity in the second half of the year than we've seen in the first quarter. And so, that's just a prudent position we've taken. And I think that if that growth doesn't occur, then obviously we have other decisions to make. David, do you want to add to that?

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David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Yeah. I think that we have built into our kind of inflation run rate on expenses in the 2.5% range. And so, if you take that, you take the investments we want to make, need to make, and have made relative to diversifying our revenue stream, we have to overcome that by having other expense eliminations elsewhere. And so, we put our $400 million program together and I think we've done a really good job of that. Our efficiency ratio target's intact of 62% this year. In 2018, we'll be in that 60% range. And so, I don't think that when you deliver to 2% GDP-type environment, that you can take your eye off of the expense ball whatsoever.

And we didn't change if you kind of went through all the changes and guidance, you also notice the things that didn't change which was our commitment to generating positive operating leverage in that 2% to 4%. So, everything is in check, but we can always continue to work even harder on expense management and we will each and every day we work hard on it.

Steve Moss
Analyst, FBR Capital Markets & Co.

Q

Okay. And then my second question with regard to the three large credits that you experienced charge-offs in, what industries were they in?

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

A

Yeah. This is Barb again. One of them was in healthcare, one was in the oilfield services in the energy sector and the third was in educational services, but you'll see it show up in our commercial real estate owner occupied because we it was secured by the real estate and those three made up to $39 million.

Steve Moss
Analyst, FBR Capital Markets & Co.

Q

Okay. Thank you very much.

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

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

A

Good morning, John.

John Pancari
Analyst, Evercore Group LLC

Q

Good morning. Also on the credit front regarding the trends, I know you indicated the inflows into NPLs in the quarter, they were also commercial related. Are they similar sectors? Are they related to those charge-offs you just flagged in the healthcare and educational services, and all of that?

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

A

Yes. They are.

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John Pancari
Analyst, Evercore Group LLC

Q

Okay.

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

A

And again, having said that, I would just say on credit in general though, I'd want to reemphasize, we're very comfortable where we are in our credit numbers, our credit metrics, where credit is going, even those three large credit charge-offs that we add. Generally not unexpected, generally they were provided for. It was simply a matter of timing as they resolved themselves in the first quarter and we want to hit and charge them off.

John Pancari
Analyst, Evercore Group LLC

Q

Okay. But despite the fact that NPLs were flat, I mean, I hear you there that you feel good about it, but I guess what I'm worried about, is that I know you didn't change your charge-off guidance of 30 to 50 bps despite coming in with that 50 bps because of those items this quarter. Is the risk to that 30 to 50 bps is going higher?

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

A

No. I don't feel that there is a risk there. Again, I feel fine about it. When I think about our non-performing loan portfolio, in total including our small credits all the way up to our large ones in the business services book, we have 73% of them are paying current and as agreed, and 98% of those that are in our C&I and CRE on our occupied area are also paying current and as agreed. So, again, I hate to position it as a good quality non-performing book, but we do see a lot of upside opportunities that those can and will return to accruing basis at some point.

John Pancari
Analyst, Evercore Group LLC

Q

Okay. Thanks, Barb. And then separately on the expense side, I heard what you said about the not re-upping your expense program or anything, but in light of everything going on what would you call your normalized efficiency ratio once we get a little bit more by way of higher rates and maybe a bit of improvement in loan growth?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.

A

Yeah that's a great question, John. So, what we've said is that we would get to that 60% range in 2018. I do think over time if you can get normalized rates, whatever that might mean to everybody, that where you're having a margin in that 3.50% range that perhaps you can be in that mid- to upper 50%s over time. I think our industry is going to have to become more efficient. I think we will. I think we'll leverage technology better in the future than we do today. But it's going to take some time to get there and so you should see us continuing to march down. Let's get to 60 and then we'll give you better guidance as to where that might end up post that.

John Pancari
Analyst, Evercore Group LLC

Q

And David, one more thing, sorry, with that 60% how much by way of hikes does that require?

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David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Yeah, what we have baked in is one and a half this year and the two the year after that through 2018, thinking of our numbers.

John Pancari
Analyst, Evercore Group LLC
Q

And therefore getting to that 60% by the end of 2018?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Say that again, John?

John Pancari
Analyst, Evercore Group LLC
Q

And therefore getting to that 60% level by the end of 2018?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

That's right.

John Pancari
Analyst, Evercore Group LLC
Q

All right. Got it. Thanks, David.

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

It's really for the year of 2018, John.

John Pancari
Analyst, Evercore Group LLC
Q

Okay. Thanks.

Operator: Your next question comes from Saul Martinez of UBS.

Saul Martinez
Analyst, UBS Securities LLC
Q

Hi, thanks for taking my questions. Couple more on capital, just to follow up. First is more of a clarification, and sorry, if I missed this in the response to an earlier question, but David, I think you mentioned that you can get to a 9.5% CET1 by 2018 or close to it organically. Is that correct? Is that for by year-end 2018? Is that for 2018 CCAR cycle? Just want to make sure I understood the specific guidance you gave there?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

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Yeah. So, what we said is we could approach 9.5% by the end of 2018 through organic growth and capital return to shareholders, and some bolt-on acquisitions, not large ones, but some bolt-on, non-bank type acquisitions during that same period of time.

Saul Martinez
Analyst, UBS Securities LLC

Q

Okay. Got it. And then just following up on your acquisition strategy or your thought process, I should say, on acquisitions and M&A. Can you just give us a little bit more color? I think obviously up until now, it's been bolt-on acquisitions, it's been focused on fee-based businesses, but could that – or under what conditions would that change, and would you start to think about perhaps more sizable deals and doing bank M&A?

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

A

Yeah, I mean, right now, we have been for the last several quarters primarily focused on organic growth, and augmenting that with a limit number of what we would call bolt-on acquisitions, those acquisitions have largely been in capital markets group and also in wealth management, in particular, in our insurance. And also in our mortgage business, you should expect us to continue to look for those opportunities to make investments. These are not large investments, but they're investments that are accretive to our earnings and we think they've been good in terms of expanding our product line, leveraging our strengths to serve our customers, and so you should continue to see that occur.

When it comes to bank acquisitions, we still actively look at opportunities and review those. Quite frankly, the economics around those today are particularly challenging given we're a regional bank stocks trade in relationship to the smaller institutions or sellers if you would. The economics that the market's giving us, they're not particularly compelling. So, we've not spent an awful lot of time looking at that. I think in any acquisition, we do have to be both strategic and the economic. And at this point in time, we've not seen that as a particularly productive thing for us to be heavily focused on. That being said, we make sure that we're mindful what's going on the market, but right now, our focus is on organic growth and on limited bolt-on acquisitions.

Saul Martinez
Analyst, UBS Securities LLC

Q

Okay. Is it fair to say that if relative valuations between smaller banks or potential acquired queries and larger banks were to narrow that on the margin that would make you a bit more apt to consider bank M&A?

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

A

If the relative multiples were to come closer together, then the attractiveness of that is an acquisition strategy improves [indiscernible] (01:00:59).

Saul Martinez
Analyst, UBS Securities LLC

Q

All right, great. Thanks a lot.

Operator: Your next question comes from John McDonald of Bernstein.

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

Hey, John.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC
Q

Hi. Good morning. Just following up on two other questions. On credit, Barb, with the reserves, ex energy at around 135%, do you think there's more room for reserve release this year or do you – you're probably going to more match the charge-offs going forward?

Barbara I. Godin
Chief Credit Officer & Senior Executive Vice President, Regions Financial Corp.
A

Well, we're back to our comment of we don't predict what the reserves are going to be. What we do is we have a very disciplined process. 135% is on the higher end. So, there could be some room for improvement, but I wouldn't want to venture a guess as to what that might be.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay. David, regarding the branch reductions, what are your thoughts on longer term potential for more branch consolidations post the 150 expected by the end of this year?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

I think, so we've eliminated more branches post crisis than any other bank. We continue to do that. And like any retail franchise, you should expect to have some consolidations and some new investments as we have new branch designs that are going in. We haven't had a lot of new branches go in of late, but we need to bolster our retail network presence in some places. And so, you should expect us to do both; consolidate, as well as to add. As we get finished with this series, we will come back with better guidance. But we don't see any large branch consolidations at this particular time, but continue to challenge ourselves in terms of what the retail network franchise needs to look like.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay. That's helpful. And one just quickie follow-up on the net interest margin near term. David, how relying is the near term expectation of that 3 basis point to 5 basis point increase for the second quarter on the 10-year being at a certain level, whether it's the 2.48% or whatever you're assuming?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Yeah. It's not all that meaningful in the near term. I think we've given you – we feel pretty confident in that range, particularly for the next quarter.

John Eamon McDonald
Analyst, Sanford C. Bernstein & Co. LLC
Q

Okay. Thank you.

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Operator: Your next question comes from Michael Rose of Raymond James.

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

Good morning.

Michael Rose
Analyst, Raymond James & Associates, Inc.
Q

My questions were actually jus asked. So thanks guys. Appreciate it.

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

Thank you.

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Okay.

Operator: Your next question comes from Matt Burnell of Wells Fargo Securities.

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

Hey, Matt.

Matt Burnell
Analyst, Wells Fargo Securities LLC
Q

Good morning, Grayson. Thanks for taking my question. David, good afternoon to you. Just a couple of quickies. One on the mortgage side of things. That's held up pretty well year-over-year and I think that has a lot to do with the purchase focus, as well as some of your MSR acquisitions. But a couple of your competitors have suggested that they are reducing the acceptable level of spreads on new production to hopefully drive some better purchase volume. And I'm curious if that's anything that you have all considered, I presume given your earlier comment, the answer is no. But I'm just wondering if you're seeing any evidence of that and if you're doing it yourself?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Yeah. No, we haven't done anything really to go out there and try to spur growth using rates. Being historically a purchase shop using our own mortgage loan originators versus third parties have been one of reasons why we've outperformed historically. If you look at our change in yields on resi mortgage, we're down 1 basis point over the quarter. So we think we can have an appropriate growth. This first quarter production was nice. Clearly, it gets challenged as rates go up. I think being a purchase shop is really beneficial to us.

Matt Burnell
Analyst, Wells Fargo Securities LLC
Q

Okay.

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

And first quarter is seasonally a soft quarter for us on mortgage originations, but the team did a very good job and really outperformed same quarter last year. And so, we got fairly strong confidence going into second quarter on production. About a third of our mortgage originations comes from referrals out of our own branches. And so, to David's point, the mortgage originators are all on our team and they're working closely with our branch offices. There are strong referral process across the two. We had about 70% purchased, 30% refinanced in the first quarter. We see those numbers shifting even stronger in the early days of the second quarter. So we think repurchase is going to be very strong in the second quarter.

Matt Burnell
Analyst, Wells Fargo Securities LLC
Q

And then, David, if I could follow up with a question in the realm of no good deed goes unpunished. We've now had three rate hikes and, I guess, I'm just curious, when do you think you start thinking about potentially reducing your rate sensitivity just in terms of trying just to reduce the concern about rates going back down?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Yeah. So that's a constant challenge for us. We think that when the market gives us our kind of returns that we want to have in our business that we would take that sensitivity down. We're not there today.

Matt Burnell
Analyst, Wells Fargo Securities LLC
Q

Right.

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

[indiscernible] (01:06:44) and continue to be asset-sensitive is important to us. So went up $100 million, and that's still in that $150 million range. We have done some things to protect us on a down rate perspective. We had taken some of the sensitivity off a few quarters ago by booking some receive fixed swaps. So I think that – I think we're in pretty good shape today and let our sensitivity run.

In part, it's really the benefit we get from our deposit base. That is so critical to us to keep that in mind as we think about our ability to continue to grow NII and resulting margins is that core sticky customer deposit base that's not as price sensitive as others. And I think right now given where we think rate increases are going, there will come a point in time we have to start paying up for deposits, we get delivered the kind of spreads and margin we want and gets our returns where we need to be and we can take our sensitivity to more of a neural state at that time.

Matt Burnell
Analyst, Wells Fargo Securities LLC
Q

Thanks for taking my questions.

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

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

Good afternoon, Matt.

Matt O'Connor
Analyst, Deutsche Bank **Q**

Hey, guys. I just want to follow up on the fee revenue side. The last couple of years you've been investing in a number of the businesses, couple of acquisitions, modest, but a couple of deals. And feels like the outlook for the fees is somewhat tempered, somewhat modest, and I know there is still some drag in the service charges. But I guess just kind of like all-in, how are you measuring the investments and the performance of those investments? And I guess the real questions is, do you want to keep trying to build out the fee businesses when maybe you haven't gotten as much momentum from what you've done so far?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp. **A**

Matt, it's a great question. I do think that's a challenge for us. Anytime we make an acquisition and purchase something to understand what that ultimate return is, I'll tell you, we're ahead of the game on most of our acquisitions that we've had over time. And I think that we do realize there are some volatility. So in a given quarter, you can't look at one of these transactions and give up on it. We continue to challenge ourselves. We know some of these aren't as efficient as some of the businesses that we have, but they're synergistic. They offer a service or product to our customers that our customers need and will pay for, so you have to look at the whole relationship profitability and not just cherry-pick one product at a time.

That being said, we have expectations on capital returns for our businesses. And if those businesses can't get the returns that we need to have and their product or business is not synergistic to our customer base, then we'll make different decisions. But right now we feel very good about what we've added over time and, frankly, are looking for other opportunities to continue to grow.

Matt O'Connor
Analyst, Deutsche Bank **Q**

And you did mention the mortgage servicing acquisition, but across the other fee categories, investments, capital markets, insurance. Any preference there or does it depend what's available on and how it might fit with you guys?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp. **A**

Well, the reason we're doing the mortgage servicing right acquisitions are for a couple reasons. The primary one is, we're very good at it. We have a group of folks that work in South Mississippi that are very talented. They've been doing this for a long time. We didn't get into trouble like others did during the crisis because of their expertise.

We also have capacity. We could add about right at $10 billion of servicing in round numbers without changing our fixed cost infrastructure. And so, we want to take advantage of that and continue to grow that portfolio. So being a low-cost servicer, I think, is beneficial to us and one area that we do have the opportunity to grow. We get deals presented to us periodically, some we turn down and some we take.

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So I wouldn't put any particular category that we would want to grow in NII. If I had to point one card, the ATM fees, card fees in particular through interchange, our credit card growth has been very nice and up about 10% last year. And that's a good product, one of our best products in terms of return, because it gives us interchange, it gives us carry, it gives us a hook into a customers, very synergistic with our business model.

And so we'd like to have more cards and so getting our penetration rate up from 18.6%, that's the penetration into our deposit base, getting that up to the mid-20% range is really important to us and the team's got that focus and I expect to get there in time.

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

A

Well, I just remind everyone, we've been very aggressive on branch rationalization, branch consolidation. And at the same time, we've been able to accomplish that and still grow accounts, grow households, deliver and get recognized for really good customer service. And all of that points to some real good fundamental execution on our plans. And at the end of the day, most of the growth on our balance sheet and on our income statement is going to come from really increase in number of customers that we have banking with us and making sure we're meeting as many of their needs that they value as possible. And so, we've really done a good job even in the face of branch consolidation. We've done a good job of growing our business across all of our consumer account segments.

Matt O'Connor
Analyst, Deutsche Bank

Q

Okay. Thank you.

Operator: Your next question comes from Kevin Barker of Piper Jaffray.

Kevin J. Barker
Analyst, Piper Jaffray & Co.

Q

Good morning.

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

A

Good morning – good afternoon, rather.

Kevin J. Barker
Analyst, Piper Jaffray & Co.

Q

Good afternoon. You mentioned that you anticipate stronger growth in the back half this year. Is that primarily due to the small business optimism that you're hearing right now, given the outlook for lower regulation and changes from the administration or is it primarily just because of other factors that are developing or a stronger pipeline?

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

A

I mean, I think that, one, when we look at the second half of the year, we are encouraged by optimism, but we're not trying to factor that in too much into our forecasts and our plans, but when we look at how the first quarter has performed economically across communities we operate in, we think first quarter was somewhat soft and so we do think and believe that the economic metrics we're following and the sentiment of our customers all sort of point

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to a stronger second half of the year. Now, we're not fully counting all of that. We're trying to make sure that we've taken a very disciplined and thoughtful approach to it, but all of our – all of our metrics, indications would tend to favor more upside in the second half.

Kevin J. Barker
Analyst, Piper Jaffray & Co.
Q

Okay. And then just a follow-up on some of the comments around capital return. Obviously, CCAR and stress tester are changing significantly this time around. Do you expect that you peer group to be a lot more aggressive this year in returning capital or do you think it could be relatively muted given last year?

David J. Turner
Chief Financial Officer & Senior Executive VP, Regions Financial Corp.
A

Well, your guess is as good as mine. I can't really comment on what others are going to do. I see what others have written about our peers, but I can tell you from our standpoint, what's incumbent upon all of us is to ensure we have an appropriate amount of capital for risk that we have. And I think most people have more common equity than they needed at this point. The question is how do each of us plan and deploy. We have our plan as we just discussed, so I think, for us, it's a robust – should be a robust return and we'll discuss that at our next call.

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

Surely not appropriate for us to comment on what others might or might not do.

Kevin J. Barker
Analyst, Piper Jaffray & Co.
Q

Okay. Thank you for taking my questions.

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

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

Good afternoon.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Thank you. Good afternoon, Grayson. Maybe you guys can share with us. Earlier, you talked about the underwriting and the loan opportunities that you guys see in the small business area, and you're missing out on some of these opportunities due to pricing and then the structure of the loans. So can you guys share with us what are some of the structures that you're seeing that really you're not comfortable with, whether it's on a real estate loan, loan to value, or possibly debt service, and how those underwritings standards compare to maybe a year or two ago?

< – [006Z6C-E John Turner]>: Gerard, this is John Turner. I'd just – maybe Barb can help me too, but I would say we're seeing more competitive pricing, we're seeing longer tenor, we're seeing higher loan to values with respect to real estate particularly in the owner-occupied real estate sector. We're seeing an appetite for more leverage than we might be willing to accept less guarantee, sometimes no guarantee where we think the guarantee is appropriate. So all those would be factors that are impacting loan growth in our view. I don't know that it's

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changed a lot, I would say since 2015, it's over the last five quarters, we think there has been less activity and so more competition for the opportunities we see. And I would guess it has – competition has impacted the marketplace for sure.

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

A

Gerard, the only other one I would throw in, there are a lot of pressure around covenant light, being more covenant light structures that are out in the market right now.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Okay. And coming from smaller community banks or other regional banks or some of the big four bank, the universal banks?

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

A

Yes.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

The competition, that is, every one.

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

A

I mean, I think it depends on the opportunity in the market, the customer and how that customer is perceived in a marketplace, it varies. But I would say the competition is competition and we see it time-to-time from everybody and I'm certain someway we'd probably say the same thing about us at some level. We certainly want to protect the relationships that we have and finding it more difficult to win new business in our existing markets.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Great. And then just pivot a bit, obviously, you guys have done a very good job in reducing the branch count, can you give us some color, and I don't know if you have any statistics at your fingertips about the mobile usage, how many of your customers use the mobile channel, what percentage of your deposits might be coming through the mobile channel, things like that?

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

A

I'll ask John Owen, Head of General Bank to respond to that question.

John B. Owen
Senior Executive Vice President & Head-Regional Banking Group, Regions Financial Corp.

A

When you look at the digital space, we could see pretty rapid growth on our mobile usage. We got about 2.3 million digital users today. Now that number has been growing double digits over the last couple of years, and we'll see that continue. From a deposit standpoint, about 30% of our deposits go through digital channels.

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Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

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

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Thanks for taking my question. Barb, can you delve into the C&I trends in terms of credit quality? Just saw small changes on the non-accruals as well as the performing TDRs, and just wanted to compare that on the non-energy side. I saw that the criticized on energy were up slightly. Just curious if there's a trend there or anything you can delve into?

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

A

It really isn't a trend. Again, as I look at what's going into [indiscernible] (01:19:53) non-accrual. This quarter we had credit in transportation, warehousing, we had a couple in energy, we had a couple in healthcare, we had one in ag. So no really trends that we're seeing, and when I look at each one and read the stories on each one, again, there's nothing that's underlying that connects any of them. They were individual circumstances. In one case, somebody died and we're waiting for estate to settle, as an example; those kinds of things.

So across the board, in general, for all of the other sectors, doing pretty well. Remember, we [indiscernible] (01:20:27) energy, but what we don't give a lot of detail on just because it's spread everywhere else is those industries that also support energy. So, one of the transportation or warehousing credits, I'm looking at the one in this quarter is to support the energy sector as an example. And I can point to a couple of others that have tangential relationships to the energy sector as well.

But broad based, again, feel good about where our credit numbers are, feel good that we will end up between that 35 and 50 basis points this year. And on the one credit charge-off that we did take, there was one this quarter that was one of the larger ones that actually, the charge-off happened on a Saturday was able to first the quarter had ended and we knew that the right thing to do was to take this quarter instead of moving into the second quarter and that was $22 million charge-off, again causing us to show more elevated charge-offs than perhaps we otherwise would have in the quarter. But again it was the right thing to do.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Got it. Okay. Thank you for the color and just a quick follow-up. If we take the remaining energy losses out of the sort of guidance range, will it be closer to the 35 basis points and if we just excluded energy on the calculation?

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

A

If you excluded the energy, it would be again somewhere between, I'm still going to say 35 basis points to 45 basis points probably, recognizing that our business mix has changed. As you recall, we talk about some businesses we're doing in our consumer book that we weren't doing previously. They're all great businesses. They're doing well. If you look at what they're providing us from a revenue perspective, they're hitting on their

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mark, but again, they're going to provide some higher losses that are going to come into that 35 basis points to 50 basis points range where they otherwise didn't in prior periods.

Christopher William Marinac
Analyst, FIG Partners LLC

Okay. Great. Thank you so much.

Operator: Thank you. I will turn the call back over to Mr. Hall for closing remarks.

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

Well, thank you for your participation. We appreciate the opportunity to tell the Regions story and we'll stand adjourned. Thank you.

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

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