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Regions Financial Corp. (RF)

Q3 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

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

Thank you, Paula. Good morning and welcome to Regions' third quarter 2016 earnings conference call. Participating on the call are Grayson Hall, Chief Executive Officer, 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 may make forward-looking statements during today's call that are subject to risks and uncertainties. And we may 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, including the Form 8-K filed today containing our earnings release.

I will now turn the call over to Grayson.

O. B. Grayson Hall

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

Thank you, Dana. Good morning and thank you for joining our call today. Our third quarter results reflect continued momentum in 2016 and demonstrate that we are successfully executing our strategic plan. We are pleased with our continued progress on fundamentals, despite a challenging operating environment. Dave is going to take you through the details shortly, but let me just provide a few highlights.

For the quarter, we reported earnings available to common shareholders of $304 million and earnings per share of $0.24. There are number of items that impacted the quarter, which we will address as we review the results, but all in all a good quarter and a solid quarter for Regions.

We delivered solid revenue growth by increasing deposits and non-interest income. Total adjusted revenue increased 5% over the third quarter of 2015, driven by strong adjusted non-interest growth of 12%, clear evidence that our investments are paying off. Notably, capital markets and wealth management both produced record quarters. As part of our continuing effort to grow and diversify our revenue, we recently announced the acquisition of low income housing tax credit corporate fund syndication and asset management business of First Sterling Financial. This acquisition complements our existing low income housing tax credit origination business, and further expands our capital market capabilities and our ability to serve our customers.

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With respect to market conditions, the global macroeconomic environment continue to remain somewhat challenging. As such, it's critical that we focus on things that are within our power to control. And to that end, we remain committed to disciplined expense management and are on pace to achieve our 2016 efficiency and operating goals.

Our plan to eliminate $300 million of core expenses over the next three years is clearly under way. However, based on current expectations for continued low-rate, low-growth environment, we have determined that additional expense eliminations are necessary to operate in this environment to go beyond the $300 million amount. To that end, we have targeted additional $100 million, which we expect to achieve by 2019. In total, this $400 million represents 11.5% of our adjusted expense base.

Turning to asset quality for just a moment. We continue to see some stress in certain segments, given where we are in the cycle, but we view our overall asset quality as stable today. In addition, the continued stabilization of oil prices has positively impacted certain credit metrics. With regards to loans, we continue to exercise caution and remain focused on prudent and quality loan growth.

Regarding business lending, average loans are down modestly on a year-over-year basis. We continued to experience muted customer demand and heavy competition in the business segment, particularly in the middle market commercial and small business sectors. We're also seeing some large corporate customers accessing capital markets and are using these proceeds to pay down bank debt.

In addition, we experienced 100 basis points decline in the line utilization of commercial customers during the quarter. Corporate customers remain focused on liquidity, which is evidenced by a 2% increase in average Corporate Bank segment deposits. Excluding the impact of public funds, average deposits in the Corporate Bank at Regions are up 5%.

In addition, direct energy loans continue to pay down or pay off. And over the past two quarters, we have seen a favorable decline of approximately $500 million on a point-to-point basis and approximately $300 million on a linked quarter basis.

It's important to point out that while reduced demand is impacting industry, we are deliberately limiting production in certain areas. For example, investor real estate in particular is an area where we remain guarded. We're also limiting exposure specifically to multi-family and medical office buildings. Year-to-date, in these – outstanding balances in these portfolios have declined approximately $300 million combined on a point-to-point basis.

Importantly, we continue to focus on achieving appropriate risk-adjusted returns within our business, portfolios and relationships. Now, we believe this approach will lead to quality loan growth in the future. Despite market uncertainty, the overall health of the consumer remains strong and we continue to see solid demand and steady growth in almost all of our consumer loan categories.

With respect to capital, we're encouraged by recent regulatory directions and comments, and the subsequent notice of proposed rulemaking, which we believe will be constructive for Regions. That said, our capital deployment priorities remain unchanged. First and foremost, we are focused on prudent organic growth. We will also continue to evaluate strategic alternatives that increase revenue or reduce operating expenses, while returning an appropriate amount of capital to our shareholders. Year-to-date, we have returned approximately 99% of our earnings to shareholders through dividends and share repurchases.

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In closing, our third quarter results reflect the continued execution of our plans and our commitment to our three primary strategic initiatives, which are, number one, grow and diversify revenue streams, two is to practice discipline in expense management, and three, to effectively deploy our capital.

With that, I'll turn it over to Dave, who will cover the details for the third quarter. Dave?

David J. Turner, Jr.

Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

Thank you and good morning, everyone. As Grayson noted, several items impacted the third quarter, and I'll speak to each of them as we move through the results. So let's get started with the balance sheet and look at average loans.

Average loan balances totaled $81 billion in the third quarter, down 1% from the previous quarter. Consumer lending experienced another solid quarter of growth, as average consumer loan balances increased $302 million, or 1% over the prior quarter. This growth was led by mortgage lending as balances increased $259 million linked quarter, reflecting another seasonally strong quarter of production. We continue to have success with our other indirect lending portfolio, which includes point-of-sale initiatives. This portfolio increased $93 million linked quarter, or 14%. Average balances in our consumer credit card portfolio increased $44 million, or 4%, as penetration into our existing deposit customer base increased to 18.2%, an improvement of 50 basis points.

And turning to the indirect auto portfolio, average balances decreased $36 million during the quarter. We continue to focus on growing our preferred dealer network, while exiting certain smaller dealers. In addition, we remained focused on achieving appropriate risk-adjusted returns in this portfolio. And average home equity balances decreased $94 million as the pace of run-off exceeded production.

And turning to the business services portfolio, as Grayson mentioned, the decrease in average business services loans during the quarter was driven by an approximate $300 million decline in average direct energy loans. In addition, loan growth was impacted by a continued softness in demand for middle market commercial and small business loans. Furthermore, we are remaining disciplined with our management of concentration risk limits and a continued focus on achieving appropriate risk-adjusted returns.

More specifically, we are limiting our exposure to multi-family and medical office buildings. And as a result, total business lending average balances decreased $979 million, or 2%, during the quarter. Despite this decline, there are areas within business services experiencing growth, such as technology and defense and asset-based lending. And we continue – expect to continue to leverage our go-to-market strategy of local bankers working with industry and product specialists to deliver the entire bank to our customers to meet their particular needs.

Related, we're also making progress with our focus on profitability and are using capital more effectively. Through July, we have achieved greater relevance in a number of large corporate relationships and improved our risk-adjusted returns on these loans over 200 basis points. Let's take a look at deposits.

Total average deposit balances increased $439 million from the previous quarter, including $330 million of growth in average low-cost deposits. Deposit costs remain near historically low levels at 12 basis points and total funding costs remain low, totaling 30 basis points for the quarter.

Total average deposits in the Consumer segment were up $483 million, or 1%, in the quarter, reflecting the strength of our retail franchise, the overall health of the consumer, and our ability to grow low-cost deposits. As previously noted, average Corporate segment deposits increased $675 million, or 2%, during the quarter, as

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corporate customers remain focused on liquidity. Average deposits in the Wealth Management segment decreased $637 million, or 6%, during the quarter as certain institutional and corporate trust customer deposits, which require collateralization by securities, continued to shift out of deposits and into other fee income-producing customer investments.

So let's see how all this impacted our results. Net interest income and other financing income on a fully taxable basis was $856 million, a decrease of $13 million, or 1%, from the second quarter. The resulting net interest margin was 3.06%. Net interest income and other financing income was negatively impacted by a $7 million leveraged lease residual value adjustment, and this adjustment reduced net interest margin by 3 basis points.

In addition, historically low rates experienced in the second and third quarters of 2016 caused prepayments in our mortgage-backed securities book to increase, resulting in higher premium amortization of approximately $13 million during the quarter. However, given the recent moves to modestly higher long-term rates, we expect $4 million to $6 million of improvement in premium amortization during the fourth quarter.

And lastly, lower average loan balances further reduced net interest income and other financing income in the quarter. These reductions were partially offset by higher short-term rates, one additional day in the quarter, and our debt deleveraging that we executed this quarter. So if you exclude the impact of the $7 million leveraged lease residual value adjustment and the expected $4 million premium amortization improvement, net interest income and other financing income for the third quarter would have been approximately $867 million on a fully taxable equivalent basis and a margin of 3.09%, and we believe the fourth quarter will approximate these amounts.

Non-interest income increased 14% in the quarter and included the impact of $47 million of insurance proceeds associated with the previously disclosed settlement related to FHA-insured mortgage loans. Adjusted non-interest income growth was particularly strong in the third quarter and reflected our deliberate efforts to grow and diversify revenue. Almost every non-interest revenue category increased, driven by record capital markets and wealth management income and growth in card and ATM fees, resulting in a 5% increase compared to the second quarter.

Capital markets fee income grew $4 million, or 11%, during the quarter, driven primarily by the mergers and acquisition advisory services group. Card and ATM income increased $6 million, or 6%, during the quarter, driven by an increase in the number of active cards and spend volume. Wealth management income increased $4 million, or 4%, during the quarter, driven by increased investment management and trust fees, as assets under administration increased 5% from $88.1 billion to $92.6 billion.

Mortgage income was stable during the quarter as increased gains from loan sales were offset by declines in the market valuation of mortgage servicing rights and related hedging activity. Within total mortgage production, 67% was related to purchase activity and 33% was related to refinancing.

Also during the quarter, we completed a bulk purchase for the rights to service approximately $2.8 billion of mortgage loans. And year-to-date, we purchased the rights to service approximately $6 billion of mortgage loans and our mortgage portfolio service for others has grown from approximately $26 billion to $30 billion over the past year. We still have additional capacity and we'll continue to evaluate opportunities to grow our servicing portfolio.

Other non-interest income includes a recovery of $10 million related to the 2010 Gulf of Mexico oil spill. We also recognized an $8 million leveraged lease termination gain, which was substantially offset by related increase in income taxes. These increases were partially offset by a $4 million decline in revenue for market value

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adjustments related to employee benefit assets, which were offset in salaries and benefit expense and resulted in no impact to pre-tax income.

As it relates to future non-interest income growth, Regions is one of the nation's largest participants in affordable housing finance through the low income housing tax credits program. And we're excited about the opportunity to enhance our capabilities through the recently announced acquisition of the low income housing tax credit corporate fund syndication and asset management businesses of First Sterling.

So let's move on to expenses. Total non-interest expenses increased 2% during the quarter and include a $14 million charge for the early extinguishment of parent company debt and a $5 million charge associated with branch closures we announced last quarter.

On an adjusted basis, expenses totaled $912 million, representing a 3% increase quarter-over-quarter. Total salaries and benefits increased $6 million from the second quarter, primarily due to one additional weekday, which accounts for approximately $5 million. Production-based incentives also increased during the quarter.

These increases were partially offset by a $4 million decrease in expenses related to market value adjustments associated with assets held for certain employee benefits, which are offset in other non-interest income that I mentioned. In addition, year-to-date staffing levels have declined 5%, or approximately 1,200 positions, as we continue to execute on our efficiency initiatives.

Looking at the fourth quarter, and excluding any impact from market value adjustments, we expect salaries and benefits to decline as a result of one less weekday in the quarter and the impact of continuing expense management. Professional and legal expenses increased $8 million during the quarter, primarily due to increases in legal reserves. As expected, FDIC insurance assessments increased $12 million in the third quarter, including a $5 million related to the implementation of the FDIC assessment surcharge. In addition, the second quarter assessment benefited from a $6 million refund relating to prior-period overpayments.

The company also incurred $8 million related to the reserve for unfunded commitments, as well as $11 million of expense related to Visa class B shares sold in a prior year. The Visa class B shares have restrictions tied to the finalization of certain covered litigation. The current quarter charge primarily relates to a class action settlement that was overturned on appeal, and we would not expect this level of expense to repeat.

For the first nine months of 2016, our adjusted efficiency ratio was 63.3% and we have generated 3% positive operating leverage on an adjusted basis. As Grayson mentioned, we have targeted an additional $100 million in expense eliminations beyond our original announcement, bringing the total target to $400 million, or 11.5% of our adjusted expense base. And we will continue to identify opportunities to pull those savings forward whenever possible.

Let's move on to asset quality. Net charge-offs totaled $54 million in the third quarter, a decrease of $18 million from the second quarter and represented 26 basis points of average loans. Charge-offs related to our energy portfolio totaled $6 million in the quarter. The provision for loan losses was $25 million less than net charge-offs in the quarter and our allowance for loan losses as a percentage of total loans decreased 2 basis points to 1.39%.

The allowance for loan and lease losses associated with the direct energy loan portfolio decreased to 7.9% in the third quarter compared to 9.4% in the second quarter, reflecting the continued improvement in our overall energy book.

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Total non-accrual loans, excluding loans held for sale, increased to 1.33% of loans outstanding. There were five energy and energy-related loans which primarily drove the increase in non-accrual loans. However, the increased provision associated with these loans was more than offset by the credit quality improvement in the balance of the energy portfolio, driven by continued energy price stabilization, as well as declines in loans outstanding.

Troubled debt restructured loans and total delinquencies were relatively flat, while total business services criticized loans increased 2%. The increase in criticized loans was driven by a small number of multi-family construction and transportation loans that were downgraded from pass to special mention.

While oil prices are continuing to stabilize, uncertainty remains. We expect cumulative losses for all of 2016 and 2017 to range between $50 million and $75 million. And should oil prices average below $25 per barrel through the end of 2017, we would expect incremental losses of $100 million. Through the first nine months of 2016, we have incurred $23 million of charge-offs related to our energy portfolio. And we are encouraged by the performance of our energy segment to-date, however, we will continue to monitor and manage it closely. Given where we are in the credit cycle and considering fluctuation in commodity prices, volatility in certain credit metrics can be expected, especially related to larger dollar commercial credits.

Let's talk about capital and liquidity. Under Basel III, the Tier 1 ratio was estimated at 11.9% and the Common Equity Tier 1 ratio was estimated at 11.1%. On a fully phased-in basis, Common Equity Tier 1 was estimated at 11%. In addition, our liquidity position remained solid with a historically low loan-to-deposit ratio of 81%.

Now, in terms of expectations for the remainder of 2016, we expect both average loans and average deposits to be relatively stable with the fourth quarter of 2015. Our expectation for net interest income and other financing income remains unchanged, with full-year growth of between a 2% to 4% range. As a result of our investments, we now expect to grow full-year adjusted non-interest income by more than 6%. Total adjusted non-interest expenses in 2016 are expected to be flat to up modestly from 2015. And we expect to achieve a full-year adjusted efficiency ratio of approximately 63%, with positive operating leverage in the 2% to 4% range. And we continue to expect full-year net charge-offs to be in that 25 basis points to 35 basis points range.

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

Dana W. Nolan

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

Thank you, 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 to accommodate as many participants as possible this morning. We will now open the line for questions.

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QUESTION AND ANSWER SECTION

Operator: The floor is now open for your questions. [Operator Instructions] Your first question comes from Matt O'Connor of Deutsche Bank.

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

Good morning, Matt.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

Good morning. I was hoping to follow up on expenses a bit and a couple of questions. I guess, one, any more color – or can you frame how much of the $400 million of cost saves will fall to the bottom line or what it means to expenses overall? And then what's the base off of? Because I'm a little confused. This quarter, the costs came in higher than expected. Part of it was higher revenue. But even adjusting for that, it seemed like a little bit higher. I know you're increasing the cost target. So I'm trying to figure out what the base is and then what it means for overall expenses.

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

Yeah. So, Matt, we have some more work to identify what that additional $100 million will be and what year it will fall in. We did extend that component of the cost elimination program to 2019. That being said, as I mentioned, we're trying to bring forward as much as we can. The base we've been working off is that base from last year, which is about $3.450-ish billion range, $3.454 billion I think to be more exact. And that's an adjusted expense number, okay? So, that's where we're tagging this $400 million off of and that's where you calculate the 11.5% from.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

And I guess just specifically in terms of this quarter's expenses, I mean, besides the items you called out within adjusted expenses, would you view kind of the adjusted expense base as being a bit inflated? I know you talked about some decrease coming in 4Q on seasonality. But is it at an inflated level?

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

Yes, that's right. That's why I tried to go through what I was enumerating, not just on adjusted schedule, but enumerated some of the unusual things that occurred in the fourth quarter. That $912 million is higher than our core run rate.

Matthew Derek O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

Okay. All right. Thank you.

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

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

A

Good morning, John.

John Pancari
Analyst, Evercore ISI

Q

Good morning. Back to expenses, just wanted to get a little bit of feel how this impacts your efficiency ratio. I mean, if you look at it, you're running year-to-date around 63.5% or so, and you came in around 65% for the third quarter. I just wanted to just get some color on how you're confident that you're going to come in below 63% for the full year 2016. What that means for the fourth quarter? And then more importantly, just overall thoughts on 2017 efficiency, what we can expect out of that.

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

A

Yes. So kind of consistent with Matt's question, we believe the adjusted number of $912 million was higher than the run rate that you'll see in the fourth quarter and into 2017. We still need some more work, John, around the 2017 numbers. We'll highlight that in the first part of December at our next conference in terms of what we think we'll do over the next three years on a number of metrics. But if you – if we put our forecast in for the fourth quarter, recalculate the adjusted expense number, we think we'll be right on top of 63%.

John Pancari
Analyst, Evercore ISI

Q

Okay. All right. Now that helps. I was just trying to go at it a different way. Okay. And then separately on the loan growth front, I wanted to see if I can get your thoughts on the outlook for loan growth for 2017. I know you flagged a couple of times the weaker business loan demand in mid-market and the conservative approach to certain portfolios that you flagged as well. So, can you talk about how you feel about loan growth as you look into 2017 considering that?

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

A

Yeah. I mean, John, if you look at our reported earnings for the third quarter, clearly, Consumer was a very strong quarter. We were very encouraged by what we saw in the Consumer not only from a loan growth standpoint, but from an asset quality perspective it continues to be very good and very stable. And we think while there's some seasonality in consumer lending, in particular around mortgage lending, we do anticipate that that positive momentum carries forward.

On the commercial side, especially in the small to medium size enterprises, we had very good production in the third quarter, but we also had an abnormally high level of payoffs and paydowns, and in particular around reductions in outstandings on commercial lines of credit. When you look at our thoughts for fourth quarter, we think production bodes well, but we do anticipate stability in the fourth quarter. I would just ask John Turner, who heads up that group for us, to add a little bit more color, because I think this is an important question.

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

A

Well, thank you, Grayson. We've said, as we think about our strategy, that we're underpenetrated in certain markets, businesses and portfolios. We have, we think, too many single-service and credit-only relationships.

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We've been good about client selectivity, but not as focused on returns. So as we think about our businesses and our desire to create a better mix of revenue, we've talked about real estate and our desire to manage that carefully, given where we are in the cycle.

Within our larger credit exposures, our Corporate Banking business, again, we want to be thoughtful. That business has been growing over the last few years, but it grows with large exposures. And so we're mindful of the tall tree risk and mindful of the returns that we're getting in that business. And so a lot of what we've been doing there over the last nine months is reallocating capital within that portfolio to relationships that are going to generate higher risk-adjusted returns. And we are beginning to see meaningful impact as a result of that. And I think it's also, as you could see, helping grow non-interest revenue, which is up almost 20% year-over-year.

And then finally within middle market and small business, it's really important, we think, that, again, we build those relationships out broadly. We don't chase opportunities. While Grayson said production was good, we had an opportunity to generate almost, again, half as much credit as we did. But it wasn't priced appropriately or the structures we didn't think were consistent with our risk appetite. So we have some levers to pull if we felt like that we needed to do that, but we believe a disciplined approach to building long-term, prudent, sustainable relationships that are profitable to the company that generate the value for our customers and for our shareholders is appropriate. And so we'll see stabilization, we think, in the fourth quarter, and then, we believe, kind of modest growth, I think, we've indicated, [ph] David (33:16), in 2017.

John Pancari
Analyst, Evercore ISI

Q

And then – I'm sorry, just one more thing. The modest growth that you just mentioned there, John, is that back to where you were previously in that sub 3% type of range?

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

A

Yes. So, John, this is David. So, we'll put together our total loan growth plan. That's what we'll share with you on the 2017 metrics. But John was trying to address, we believe – we will have certain things working against us, energy being the big one, in 2017 as much as we had this past year. So we'll give you more specificity on loan growth at the next conference.

John Pancari
Analyst, Evercore ISI

Q

And did you – thanks. And did you quantify the paydowns in the commercial real estate side?

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

A

I don't think we did. I can't recall whether we...

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

A

The main decline we had talked about was energy. Over the last couple of quarters, it's been about $500 million with average of $300 million of that this past quarter.

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

Yes. I think the number in real estate was about $300 million, right, point-to-point. And again, as we're trying to remix our business, real estate is an example, and shift from a very high level of construction loan production to a better mix of term lending and construction lending, we can't manage the timing, as you can imagine. And so, it is going to be a bit lumpy as we experience paydowns in the construction book and we seek to grow the term book. And so, we over time expect to grow real estate as the economy grows, but we'll have, I think, some timing differences as we attempt to remix that business.

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

But, John, as you saw in this quarter, when we – with all the actions we're taking, we're actually reducing the risk profile of our overall loan portfolio and are encouraged with the progress we're making in that regard. It does create some noise on a quarter-to-quarter basis, but I think the point is we're trying to be very thoughtful and very prudent about reducing the overall risk profile of our portfolio.

John Pancari
Analyst, Evercore ISI
Q

Okay. Thanks, Grayson. Thanks for taking all the questions.

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

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

Hi. Good morning. I wanted to ask a little bit about credit quality. The charge-offs, David, this quarter came in at the low end of your range with the 26 basis points. Do you expect to hold the lower end in the near term in terms of the charge-offs? And then, on the reserve front, are you comfortable letting the reserve go further down from this 1.39% or so, or do you expect the provision to kind of match charge-offs going forward?

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

Yes, this is Barb. I'll take that question. Relative to – I'll touch the reserve first. As you know, we have a pretty prudent ways we go about looking at it, consistently we go looking at our reserves. So we will let the numbers speak for themselves at that point. However, I don't see us going back to what we call the old days of something sub-1% coverage. We came at 1.39%, as you know, so we'll move in and around that band for what that's worth relative to charge-offs. It was a great charge-off quarter. I would stick with our guidance of 25 basis points to 35 basis points as we close out the year, and that would include the fourth quarter coming up.

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

But again, there can be considerable volatility from quarter-to-quarter, given the granularity of the portfolio and some of the larger credits we have. But overall, to Barb's point, very good quarter from a credit quality standpoint this quarter; had a lot of things moving around, but at the end of the day we think we're in a good place.

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

Q

Okay. Just to follow-up on that, Barb. The consumer charge-off ratios, if we look in the supplement, is showing a trend of going up. And obviously, you're growing this from a small base. So just kind of wondering what you're seeing there. Is it seasoning that you kind of expect on this trend? These are small numbers right now, but as you grow this consumer portfolio, do you have destinations in mind for where these charge-off ratios should be headed?

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

A

Yes. Firstly, they're all within our risk appetite, so we're very comfortable with what's happening in the Consumer book. What we see is real estate continues to improve. In particular, the home equity was down significantly this quarter. Mortgage is really back to its all-time low tracking along the bottom. Some of the other portfolios that we see, indirect is pretty stable. And then, of course, we have a handful of new initiatives that we're looking at that contributed a little bit, a few million to our numbers overall. But again, on the revenue side, we're seeing that handful of increased losses are more than offset by the increased revenues. So we don't see the Consumer book moving up significantly in terms of overall losses at this point.

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

Q

Okay. Thank you.

Operator: Your next question comes from Betsy Graseck of Morgan Stanley.

Elizabeth Lynn Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Good morning.

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

A

Good morning.

Elizabeth Lynn Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Hey. A couple of questions, one is on expenses. Just in general, what do you think your normalized expense increase is on an annual basis, not including the cost saves, but just what you have to consider as normal course of inflation of expenses?

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

A

Yes. I think if you start back at that $3.454 billion number and it could go up modestly there, we're hitting that run rate of – adjusted expenses $912 million, that's a little bloated. I tried to enumerate those. If you carve those out, you're going to be in that $880 million range, $885 million range is probably where that's more normal run rate at this point.

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Elizabeth Lynn Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay.

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

A

But that's all adjusted. It's all adjusted.

Elizabeth Lynn Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Right. So, if you're talking about a 2%-ish or 3%-ish normalized increase from just salaries and expense inflation, then we're looking at over a three-year period an outlook where you should be able to bring your expense dollars down over a three-year period. Is that fair?

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

A

Well, one of the things that's important to us strategically, as we laid out in Investor Day, is to grow and diversify our revenue and to continue to make investments. In order to make those investments, we have to – and control expenses at the same time, we have to have savings from kind of our core operations. And that's really what the $300 million – now $400 is all about. And so we have to continue to find other ways to become more efficient, because it is [ph] firstly (40:05) important for us to continue to grow our company and to grow non-interest revenue in particular. And so having a reduction in expense versus having a flat to up modestly, which is what we have today, and again we'll give you 2017 and beyond that it will be somewhere in that range as well.

Elizabeth Lynn Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay. So, yeah, what I'm missing in my little calculation is the investment spending you're making, okay. Okay. And then just separately, you no longer have to deal with the qualitative part of CCAR test. I know the regulator says that they're going to be assessing your process in the normal course regulation. But maybe you can give us a sense as to how much that helps you in terms of dealing not only with the CCAR itself at that point in time in the year, but also how you think about the capital return that might open up for you without the qualitative test issue that you have had to deal with over the past few years?

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

A

So I would start with, obviously, the – it's still just a notice of proposed rulemaking, so we still need the finalization there. But based on what is out there, I think it's constructive for the industry, for the regional bank space. That being said, we managed our capital in the manner we played out a capital planning process and all the governance, and none of that is going to change. We're going to continue to have robust capital planning and loss forecasting. What this does is that plus learnings that we get from each CCAR filing help us frame up what we could do with our capital.

First and foremost, we want to leverage our capital to grow organically, and that's the first order of business. We want to make investments for bolt-on acquisitions that we've done. You saw the one we released yesterday. Those are important. Having a fair dividend to our shareholders is important. And then when we have excess capital that we're generating, having an appropriate return in the form of a share buyback is in order.

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So, I think given all of that, it gives us an ability to think about capital targets relative to the risk that we have in our balance sheet. And we've mentioned that based on today's risk that we have, that Common Equity Tier 1 ratio with 9.5% is where we would target over time and we're at approximately 11%. So we have capital to be put to work or to be given back to shareholders over time. And so I think all the body of evidence that we have will help us manage that in a prudent manner over perhaps a shorter period of time. We have to think through that. So, Betsy, it's a little early to tell what that exactly means for our CCAR submission in 2017.

Elizabeth Lynn Graseck
Analyst, Morgan Stanley & Co. LLC
Q

Okay. Thanks.

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.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Good morning. Just wondering if you could give us some color around the increase in criticized loans in the multi-family and transport area.

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

Absolutely. Betsy (sic) [Jennifer], it's Barb again. So what we have is we have effectively in multi-family three credits. Two of them are in the Houston area; one was in Oklahoma. The one in the Houston area, I'll give you a little more color on. Higher concessions than originally expected, so we moved that to a special mention loan. Another that was also in the Houston area, construction delays due to rainfall, so we moved that one over.

And the last one is in Oklahoma, 93% complete on that building, marginally behind schedule in terms of the leasing, but we still expect completion of the building by the end of December. So, again, we look at everything relative to how you are supposed to be performing on any of these credits. And if you're not performing as per what we originally laid out, we will move you to a special mention.

The transportation credits are energy-related; one large transportation credit energy-related. What I would say, though, about our overall criticized book is that 93% of our criticized book in the business services area is paying as agreed. So I don't expect at the end of the day that there will be a significant number of losses at all coming from any of those loans that we moved over.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.
Q

Okay. Separate question on your branch sales incentives. Grayson, do you expect any meaningful change to your branch sales incentives given the backdrop of what's happened with Wells?

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

A

Yes. I think given the backdrop that the industry is facing right now, I think the prudent thing to do, and I assume all of our competitors are doing that, is taking a very deep dive on all of our sales practices using both our internal leadership, internal experts, as well as external advisors to re-challenge our sales on all of our sales practices. We're quite proud of the culture we've built in Regions. We had a sales culture that is really based on shared values, making sure that it's customer-focused and we're doing the right thing for customers in the right way. And our messaging is quite strong and the feedback we get from surveys and external sources is very encouraging.

But all that being said, we believe in the backdrop of all that's going on that we're all re-challenging ourselves to make sure that everything is done correctly and appropriately, and that activity is going on here as I'm sure it's going on everywhere. But as I said, we've got a lot of confidence in the processes we've built. We think we're doing the right things, but more importantly, we think we're doing them the right way. But we've got to make sure that that's occurring in all aspects. And so, given the backdrop, we're re-reviewing everything we're doing.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thanks very much.

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

Stephen Moss
Analyst, FBR Capital Markets & Co.

Q

Good morning.

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

A

Good morning, Steve.

Stephen Moss
Analyst, FBR Capital Markets & Co.

Q

Just want to circle back on expenses a little bit. I know in the past you've talked about pulling forward expenses, and I was wondering what's the possibility that the $300 million, you can complete it in 2017.

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

A

Yes. So, we are continuing to challenge ourselves on the $300 million plus the additional $100 million in terms of timing, and are looking to pull forward as much as is prudent without harming the long-term franchise. So, I can't give you probability of being able to complete that in 2017. I think getting all of that in 2017 would be very difficult. But could we move some of it that is currently in 2018 into 2017, I think that's an appropriate challenge to our team. And we'll be coming back again after this challenge, and in December at our next conference, we'll lay out what that three-year plan looks like, including metrics like operating leverage and efficiency, and just total expense bogey as well.

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Stephen Moss
Analyst, FBR Capital Markets & Co.

Q

Okay. And then my second question on investment securities yields, just wondering, what is your new money purchase yield these days?

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

A

Well, we're in the – mortgage-backs are about 1.75% to 2% and corporate bonds are 2.30%-ish range to 2.75%. But the preponderance of what we're at have been adding to mortgage-backs.

Stephen Moss
Analyst, FBR Capital Markets & Co.

Q

Great. Thank you very much.

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.

Michael Rose
Analyst, Raymond James & Associates, Inc.

Q

Hey. Good morning. Just another follow-up on expenses. The additional $100 million that you identified, is there – and I'm sorry if I missed this. Is there any change in kind of the complexion of what that $100 million comprises relative to the $300 million that you laid out at Investor Day?

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

A

No, Michael, those are – if you go back to Investor Day, you'll see roughly four broad categories of expense. I suspect they'll fall into those categories. I think you should expect us to leverage – see us leveraging technology a bit more, which gives us time to put things in place to help us from an efficiency standpoint. So that could be one of the changes.

As we go through this, we kind of started on the human capital size and then getting into really third-party spend, which we've done some of. There is probably some more room there. We continue to work on occupancy cost and branch consolidations and office space. As you know, we had 1 million square feet we wanted to take out over the initial three-year period of time. We're in good shape with that. But we're continuing to challenge ourselves on those kinds of areas. We think there will be more to come there.

Michael Rose
Analyst, Raymond James & Associates, Inc.

Q

Is it fair to say that most of the kind of heavy lifting from the expenses efforts have been realized at this point? One of your competitors this morning basically said that they had anything kind of incremental beyond today's announcement, it would be much smaller. Is that a similar view for you guys? Or if you were to take a more critical look at your branch network, could you actually see some more material savings as we move forward?

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

A

No. I mean, Michael, you look at the past few years, we have been very focused on efficiency and trying to find expenses. And obviously, the duration of this operating environment has continued to put substantial pressure on expense management, and a lot of the easy first steps are all behind us in terms of expense management. And really, what you're doing now is having to sort of transform how you do business. And if you look at the investments we've made in a lot of our digital channels, investments we've made in sort of retooling our branches and how we operate out of our branches, we're really, at this point in time, having to really challenge ourselves on how we go to market in certain parts of the company and, as David said, using technology to make those people more efficient and more effective.

So to answer your question, easy expense saves are long behind us, have been for a while. And so the things we're doing now are much more transformative; interesting, take a little more longer to execute. But at this juncture, you really have to look at how you do business rather than just trying to look at normal inefficiencies of process.

Michael Rose
Analyst, Raymond James & Associates, Inc.

Q

Okay. That's helpful. And then maybe just one more for Barb on energy. I appreciate the guidance around charge-offs for energy [ph] reiteration (52:03) that you provided. What would cause you to be kind of at the lower end of your range, and then what set of variables would cause you to be at the upper end of that $75 million?

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

A

Yes. Michael, it's clearly oil prices, where they sit right now, generally around that $50 area, that provides some stabilization. But we honestly don't believe that things will really move in the right direction until we get somewhere in the $60 a barrel range, give or take. But if they stay at $50, we do see stabilization in our metrics. If they go down into – again, you saw our guidance of sub-$30, we would expect significant increases, i.e., being an additional $100 million. But if oil got down into the $30 a barrel range as well, we would also see some upward pressure on our – all of our credit metrics and in our [indiscernible] (52:55) as well.

And by the way, just for some more color on the energy charge-offs that we did have this quarter, of the $6 million that we had, roughly $1.5 million was coal. So year-to-date we've had $23 million in energy charge-offs, and of that, approximately $9.5 million, $10 million is related to the coal portion of our book as well.

Michael Rose
Analyst, Raymond James & Associates, Inc.

Q

That's very helpful. Thanks for the color.

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

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

A

Good morning, Geoff.

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Geoffrey Elliott
Analyst, Autonomous Research LLP

Q

Hello. Thank you. Thank you for taking the question. In your prepared remarks, I think you mentioned examining strategic alternatives to increase revenues or reduce expenses. I wondered if you could elaborate on what you were referring to there.

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

A

Yes. So when we talk about strategy, it would be the things like we saw yesterday with our announcement of First Sterling, continuing to make any type of investments that are helping us to serve our customers, to give us a more fulsome offering to our customer base as we seek to meet their needs.

There are other investments that we seek to make. We talked a little bit about leveraging technology to help us from our cost standpoint over time. So we're looking at different technologies to help us – look at process improvement to help us where we might be able to get a better answer to take labor out and improve our internal control structure for making those type of technology investments. So those were kind of the ideas we had.

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

A

Yes. We really believe the best strategy for us at this point in time is to really focus on executing our plans. We've got plans that allow us to continue to improve the fundamentals of the company. If you look at the fundamentals, the fundamentals are posting out some very good numbers, in particular on the Consumer side of our house, but really across the board. And so, that focus on execution is a key point of what we're doing.

And the other side is innovations. I think in this market you got to be able to execute but you've also got to be able to innovate. And so, we're spending an awful lot of time trying to figure out how we innovate in a way that better serves our customers and does it in a way that creates greater efficiency in the way we operate. So I think that we got a number of good strategic moves that we're making that will help improve the overall performance of the company.

Geoffrey Elliott
Analyst, Autonomous Research LLP

Q

So it sounds like the focus is more around bolt-on acquisitions where you think you can do something to improve efficiency rather than selling businesses which you look at and you don't think they fit anymore.

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

A

I think actually what we've done thus far that you've seen our advancements on things like our GreenSky initiative, Avant was an initiative. We do challenge ourselves on our businesses to ensure that they are seeking appropriate risk-adjusted return on the business. And when we have a business that can't help us meet our return hurdles and/or don't serve a customer, then we'll challenge ourselves on that.

But right now, it's been investments that really help us grow and diversify revenue. And that diversification is moving a little bit away from NII to NIR. It's moving geographically. It's diversifying in products and services that we offer to give us a little more balance in terms of how we generate revenue and earnings for our shareholders.

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Geoffrey Elliott
Analyst, Autonomous Research LLP

Q

Great. Thank you.

Operator: Your next question comes from Jill Shea of Credit Suisse.

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

A

Good morning, Jill.

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

Q

Good morning. So maybe just on fees, you are on pace to grow fee income by more than 6% this year and you had some nice growth across capital markets, card and wealth. Can you just speak to some of the momentum that you're seeing in your fee income the remainder of this year and into next?

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

A

Yes. I mean, I'll ask John Owen, if he would, to sort of talk about some of our fee rates businesses and some of the growth rates you're seeing there. It's a very encouraging story.

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

A

Sure. Thanks, Grayson. Good morning, everyone. As Grayson said, we're seeing steady improvement in our Consumer business. If you look at an account growth standpoint, we're going to grow checking accounts about 2.5%, debit card growth about 4% year-over-year, credit card growth about 12% year-over-year, now banking customer account growth by 14%. The other point I would make is utilization on debit cards both total transaction and spend is up as well on cards. So, those are driving lot of our increases.

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

A

Thank you.

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

Q

And then maybe just any color on capital markets involved and some of the momentum you're seeing now.

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

A

Sure. This is John Turner. We're continuing to build out our debt capital markets platform, and doing that across a number of different products and capabilities. So, what you've seen is we've grown capital markets revenue significantly over the last two years is the introduction of some of those products and capabilities. We had a very nice third quarter largely built on the M&A advisory revenue that we generated. We also had a pretty good quarter in real estate permanent placement, particularly through our Fannie DUS license.

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We expect to continue to see that kind of growth going forward as we continue to leverage these new capabilities. We're excited about the acquisition of First Sterling businesses. The Community Investment Capital business is one that's been very important to us. We decided that we wanted to grow that business strategically two years ago. We've set out to find a syndication platform that will help us build out some distribution capabilities that we didn't have. So, again, that's another product capability that we have that will allow us to meet customer needs, grow revenue in a more diverse and balanced way. And we expect to see, again, nice growth in capital markets into 2017 as we leverage more of these capabilities.

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

Thank you.

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

Good morning, Matt.

Matthew Hart Burnell
Analyst, Wells Fargo Securities LLC
Q

Good morning, Grayson. Thanks for taking my questions. First on margin, I thought I heard David mention something about some loan re-pricing efforts that you've been able to pass through. I'm curious if there's more of that to come and what the benefit might be going forward. And I guess in a related question to David, how do you think of a 25 basis point hike, if we're lucky enough to get it in December, would benefit Q1 margin? Last year, it was about a 5 basis-point benefit quarter-over-quarter on an adjusted basis. Should we see something similar in the first quarter if we were to get the 25 basis points?

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

Yes. So I'll start with your second quarter first, and I think when you look at 25 basis points to see where we're positioned, you're probably for the year in a $15 million, $20 million range, so your number is not too far off for the first quarter.

Matthew Hart Burnell
Analyst, Wells Fargo Securities LLC
Q

Okay.

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

I would tell you, as we think about the returns, improving our returns, that's not just a pricing issue only. It's really the relationship. It's trying to get the relationship return, which can include credit, but it's going to include all the other products and services that we offer that customer.

Matthew Hart Burnell
Analyst, Wells Fargo Securities LLC
Q

Right.

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

And so, we certainly are looking at things that have a credit-only relationship, that have a suboptimal return for us, and those are the ones we want to try and get the relationship, get our price improved, get our returns better or recycling and leveraging that capital into another option or another alternative. So I think over time what you ought to see is, we should have some positive impact to the margin, the pace of which is really dependent on how we change this whole relationship and whether it's credit-related or product and service-driven.

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

I would just add, as we look at yields, going on spreads over LIBOR did improve during the quarter. More importantly though, as David talked about, I think you're seeing is a growth in fee revenue, a growth in deposits, all because of our focus on relationship returns. Just to underscore the work that's being done, talk about our Corporate Banking portfolio, particularly shared national credit book and our desire to improve returns in that business, we actually exited almost $2 billion worth of credit in the first nine months of the year. We reallocated that capital back into new relationships and existing relationships, and in doing that, we increased the revenue per relationship over 50% and the risk-adjusted returns in the business by almost 250 basis points. So we are seeing that activity really begin to have an impact. It will take some time to see it in the P&L. We believe that it is occurring, and it's the right approach.

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

And, Matt, I'll add. This is David. In terms of kind of margin expectations I tried to put in the prepared comments, we had a couple of things that were fairly unusual in the fourth quarter that pushed our margin down to the 3.06% that we think rebounds a bit in that 3.09% range, give or take. There are a lot of things that can move, but based on the best evidence we have today, we'd be in that range. I gave you about $11 million of NII that was a bit different for the quarter that we think helps get you some stability in terms of NII and resulting margin for the fourth quarter.

Matthew Hart Burnell
Analyst, Wells Fargo Securities LLC
Q

Sure. No, that makes sense, David. Thank you for the color. And actually your comments earlier about the re-pricing and relationship are a nice segues into my final question. Specific to the capital markets business, how far along are you relative to where you'd ultimately like to get in terms of cross-selling those investment banking, capital markets products into your corporate middle market customer – credit customer base?

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

This is John Turner. I'd say we're probably 70% along in developing – 70%, 75% developing the product capabilities that we'd like to have in our debt capital markets business, and maybe 20% to 25% along in terms of really capturing what we think is the opportunity within the business. Today, about 24% of our total revenue in the Corporate Banking business is non-interest revenue, and we'd like to see that number improve to 40%-plus over time, which means we've effectively got to double the business, and we think that there's visibility to get there. It will take a while, but we see the opportunity, clearly.

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Matthew Hart Burnell
Analyst, Wells Fargo Securities LLC
Q

Thanks for answering my questions.

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

Sure.

Operator: Your next question comes from Ken Usdin of Jefferies.

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

Thank you, Ken.

Ken Usdin
Analyst, Jefferies LLC
Q

Hey, guys. Good morning. Just one quick follow-up on credit. You talked about the quality of the book improving over time as you remix. This quarter we still saw your ability with the energy improvement to release some reserves and the overall reserved for loans ratio is still quite high versus almost all peers at [ph] 1.4 (01:05:07).

But just can you talk about philosophically over time with that change in the mix of the business, do we see that reserve to loans ratio continue to come down? And as credit continues to improve on energy, is there more room to still be releasing as we continue to see the improvements on the resi side as much as the potential improvements in energy? Thanks, guys.

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

Yes, Ken, it's Barb. And so as we book loans – book new loans, we're always going to have a provision associated with those. So, we'll put that as a positive to increase the provision. On the other side, as our books continue to get better and our ratings improve on all of these credits, we also have the opportunity then again to reduce our overall provision on these.

So net-net, over time, if we're suggesting that we're going to have a book that's stable to some continued improvement, then you should see some stability in the provision to improving. And again, a lot of that build will be driven by energy. You saw that this quarter. So as the number of energy credits got much better, we were able to reduce our overall level of provision, roughly $50 million in that book, and we'll continue to review that book every quarter as we move through the next several quarters and see how that impacts our overall numbers.

Ken Usdin
Analyst, Jefferies LLC
Q

Just a follow-up. Do you expect that the new stuff that you're adding on the consumer side, is that higher loss rate content? Do you have any change in your kind of philosophical, like what your through the cycle loss rate should be? I understand there is a lot of current things that are plus and minus underneath.

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

A

Yeah. Our overall philosophical, we stated 75 basis points of loss through the cycle. We still believe that that's the right number. Consumer book was heavily weighted towards real estate, and again real estate tracking in those low double-digit numbers in terms of losses. But also it doesn't give you the returns that some of the other products that we're looking at do give us. So the answer is, yes, we will see some increased credit cost on the Consumer side, although we think, again, they're going to be quite manageable. We do have limits on concentrations on any of those new initiatives that we do.

Ken Usdin
Analyst, Jefferies LLC

Q

Okay. Thanks a lot, Barb.

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

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

A

Hi, David.

David Eads
Analyst, UBS Securities LLC

Q

Good morning – or slightly afternoon now. Maybe just a follow-up for Barb here on, can you give a little bit of color on what you're seeing in the oil field services portfolio? It looks like you've had some declines in balances and commitment, but you had a tick-up in criticized. I mean, is it one of the things with that portfolio really is the only part that you're really worried about here and that improvements elsewhere are more than offsetting some continuous headwinds there.

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

A

Yes, I think you're correct. I think on the E&P side of our book, that generally what we've seen is certainly some stabilization, especially with prices where they are for a barrel of oil. We have talked about in prior quarters that the oil field services portion of our book will lag in terms of recovery to the E&P portion of our book. And we're seeing that. And that's the reason we're continuing to guide that between now and the end of next year we believe our total overall losses will be somewhere in that $50 million to $75 million potential total range. We are seeing that oil field services – here and there there's pockets and we are seeing that they are getting back to work. But again, that is, as I've said, going to take I think the rest of 2017 for that to work itself out.

David Eads
Analyst, UBS Securities LLC

Q

All right. And then you mentioned comments earlier about multi-family and some of the medical care facilities pulling back from those. And just want to get the read. Is that more about hitting concentration limits and wanting to be disciplined on that front as opposed to seeing any kind of specific signs that are worrying on that – kind of excluding some of the comments you made about Houston energy-related locations where you're saying you had some downgrades this quarter?

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

A

You're exactly right. We do have a very disciplined concentration methodology. We've learned a lot coming out of the last crisis, and what we learned is diversification of our books and concentration limit management is paramount to having a good, solid, prudent book. And so as we've come up on some of our concentration limits, we've worked very closely with, in particular, John Turner and his team to, again, recycle capital, but also stay well within those concentration limits. And again, that's the reason for the commentary on that, and the same thing with our medical office building.

David Eads
Analyst, UBS Securities LLC

Q

Great. Thanks.

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 afternoon, Marty.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

Hey, thanks. I got two bigger strategic questions. As you look at Barb talking about your through the cycle losses, you all are spending a lot of time de-risking, offloading what could be some of the more troublesome loans. Really over time to get the benefit from that – I think you're seeing that with lower losses now, but you should also see it with less volatility when we get in that downdraft. I think communicating and talking about the benefits of the de-risking is going to be very important for Regions. Just your thought on as you keep saying, 75 basis points the benefits of de-risking and how you can see it materialize over time.

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

A

All right. Thank you for those comments and you're absolutely right. We have spent a lot of time on the de-risking. [indiscernible] (01:10:51) de-risking was, as you know, in the real estate book what we wanted to do is, as we thought of how do re-risk our portfolio that we do it with assets and we do it with portfolios that are much less volatile and back to again that we do it within our concentration limits, so that we don't get outsized in any one area, in any one product and sticking to that discipline.

The other challenge that you have when you de-risk a book and by de-risking you sell a lot of the assets is you don't enjoy the recovery stream after. Whereas, if you instead manage a book that is prudent and less volatile when you do have losses, you do also anticipate a benefit and also having future recoveries. So those are lot of benefits to making sure that we stay within a pretty tight [ph] data (01:11:38) on what we're doing.

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

A

Because, Marty, we really are trying to make sure that we're not only diversifying, but we're remixing our loan portfolio to have it be a better performing asset through the cycle with reduced volatility, exactly to your point. We're trying to be very careful about client selectivity, trying to make sure that we understand who we're banking

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and how we're banking them, and we try to make sure we've got a full relationship with that client. And we do believe that there'll be points in the cycle where we'll grow less than some peers, but we do believe that what we're doing in diversifying and managing concentration risk will, in fact, reduce the overall operating volatility of our company over a longer period of time.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

No, I have seen that and I just think that communicating and materializing how that's going to kind of play forward is going to be important. And then, David, on the extra $100 million in expense savings, you've been producing 2 percentage points to 3 percentage points of operating leverage, and actually revenue growth is picking up. So I just want to go back on how you couched it in this environment. It almost seemed like things weren't improving or you weren't getting revenue growth, so you had to go and dig harder.

Are you just finding things as you've gone through, like you said, redesigning that gave you another $100 million that you can now put on the table? I think the difference between that feeling is pretty important. Is it desperation or is it, no, we're just finding more things that we can do more with?

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

A

Marty, I would put it this way. We've been really working with a great sense of urgency on efficiency. We know it's important. But we're finding investment opportunities and we know in this environment that we have to figure out how to self-fund those investments. We have to figure out how we can reduce our expenses to make those investment decisions. And those investment decisions are getting traction now. We're starting to see the benefits of some of the decisions we've made in terms of investments. You're seeing that very strongly in capital markets.

But as we've gotten into this process, we've just come to the conclusion that, if this environment persists, we got to be even better. And we're finding opportunities that will allow us to extend this process further, and we believe get our company into a much better position. We do believe that operating leverage is the right metric to look at. We continue to believe we're delivering on that. But it's going to require both – work on both revenues and expense side of the income statement, and so we can't give up on either one.

Marty Mosby
Analyst, Vining Sparks IBG LP

Q

And then one tactical question. David, you had $13 million negative in prepayment write-offs. You're getting about half of that back in the fourth quarter. But if rates stay where they're at or at what level do you have to get to get the other $6 million back into your quarterly NII from pre-payments going back to where they were in the prior quarter?

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

A

Yes. I think where we are clearly is beneficial. We, obviously, are seeing a lot of volatility though in rates. And I think that you're right, we'll get a piece of that back naturally because of what has happened. But I think that it's going to be – it's a little premature to say when we might get that other piece in. We need to see what will happen over maybe the next couple of quarters before we can get our – that premium amortization down into the lower 40 range.

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Marty Mosby
Analyst, Vining Sparks IBG LP

Q

Thanks.

Operator: Your next question comes from Erika Najarian of Bank of America.

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

A

Good afternoon, Erika.

Erika P. Najarian
Analyst, Bank of America Merrill Lynch

Q

Good afternoon. I apologize in advance for prolonging the call on one more expense question, but I just wanted to make sure I understood David's response to Betsy's question correctly. The way it was framed was the core run rate for expenses was $880 million to $885 million, plus potentially a natural growth rate of 2% to 3%. Should we then, on top of that, separately think about the $400 million of savings, and that $400 million is being used to fund all those investments that you've been talking about for the past hour?

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

A

Yes. So, I think if you look at our kind of core, that $880 million to $885 million is where we are. We do continue to make investments to grow our revenue, so an example will be our release we had yesterday. You'll see expenses coming through from that investment in 2017 and none in 2016. And so, we're trying to figure out how to pay for that by having other savings, so part of that $400 million is to compensate us for that.

We do have built in natural inflation that we have, salary increases and the like, that we try to curtail by ensuring that we have the right number of people – the right number of the right kinds of people to manage our business and run our businesses. We're down some 1,200 people and we continue to challenge ourselves on that. And you see some of that manifest in the branch consolidations that we've had during the year.

So the question is, how do we keep the $880 million and $885 million as stable to up modestly as we can while we're making the investments to grow revenue and having things like First Sterling with 12 months' worth of expense next year and virtually none in 2016. Does that make sense?

Erika P. Najarian
Analyst, Bank of America Merrill Lynch

Q

It does. Thank you.

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

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

A

Afternoon, Kevin.

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Kevin J. Barker
Analyst, Piper Jaffray & Co. (Broker)
Q

Good afternoon. Thanks for taking my questions. I just wanted to follow up – not to beat a dead horse, but follow up on expenses again. You say flat to up modestly on a yearly basis. I mean, that could be a very wide range going into the fourth quarter. Are you assuming that the run rates could be closer to the $880 million to $885 million range going into fourth quarter, or is it going to be – could you see some volatility where that would drive that number lower?

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

We believe that's our core kind of run rate where we are right now for the fourth quarter, is in that $880 million to $885 million.

Kevin J. Barker
Analyst, Piper Jaffray & Co. (Broker)
Q

Okay. And then when you think about the revenue side, when you say it's going to be, on a yearly basis, up around 6% or more than 6%, that's a run rate closer to $500 million going into next quarter from $544 million. But it seems like you have a lot of positive commentary around your momentum on the fee income side. It seems like that number could be up a lot higher than the 6% that you're guiding to. Is there some moving parts there that may cause the number to come down considerably going into the fourth quarter?

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

We've had – we grew just about every category of non-interest revenue, and we're excited about those investments that are paying off that we've made. So I don't see that – the 6%, the reason we've left it there is our initial target at Investor Day was 4% to 6%. We had said we'd be in the middle, and then we said we'd be at the upper end, and now we're giving you guidance that we'll be over 6%. But that's where we stop, and we haven't – we're letting you draw your own conclusion as to what percentage you want to use over that. But there's nothing that indicates to us that we have any type of major disruption in that trend that you're seeing.

Kevin J. Barker
Analyst, Piper Jaffray & Co. (Broker)
Q

Okay. Thanks for taking my questions. Thank you very much.

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.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Good afternoon, Grayson. Good afternoon, David. Couple of questions for you. David, you touched on the premium amortization and how it's going to improve obviously in the next quarter and in an earlier question you talked a little bit about and maybe getting even better if rates go higher. Can you quantify where rates would have

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to go, the 10-year government bond yield that is, when the premium amortization would really drop significantly and be a non-factor?

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

A

So I think if you took the 10-year maybe up closer to 2%, we might have some meaningful reduction in the premium amortization, and that's just an approximate, because obviously what happens with prepayments, refis and mortgages didn't always totally correlate to the 10-year. But suffice it to say, that's a pretty good proxy.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Okay. And then on the other end, if we were to see a higher level similar to what we saw this quarter, would the 10-year need to get close to the 1.60 or below for that to reoccur?

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

A

Yes. I think that we're coming off of pretty historic lows in the second quarter. And when you look at that, I – that's why we were able to give you maybe that $4 million that we don't think will repeat. But you'd have to be steady in the 1.50s for the quarter for it to get anywhere close to where it was.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Okay, great. And then coming back to the capital question, obviously, Grayson, you talked about using the capital deployment for organic growth and strategic alternatives. And, David, you pointed out that you're comfortable with the CET1 ratio at 9.5%. If the NPR turns into an actual regulation about the qualitative portion of CCAR, you are not going to have to go through it anymore. Would you guys consider doing an accelerated share repurchase agreement in the next CCAR exam or a Dutch tender offer to really pull out a lot of excess capital to bring you down closer to your 9.5% and obviously the ROE would go higher?

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

A

I mean, I'll let David add to this, but we do believe that the proposed rules are constructive and give us more certainty. And we do believe that given the risk profile of our company today as we run through CCAR that given the current mix that we think we're in that sort of 9.5% range, as David said. Obviously, we're trying to improve the mix of our portfolio. That'll change some of our metrics if we're successful in that regard.

But the rules that are proposed give us more certainty, but we feel it's our responsibility to manage capital and do that prudently and thoughtfully. And assuming the rules get approved in somewhat similar fashions they stand today, I think it is constructive for our bank and constructive in general for a lot of the regional banks and will give us more flexibility. All that being said is we're still some time away from those strong deliberations that go into our submission. And so it's premature for us to comment on what we might or might not do in that regard. But it's a possibility.

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

A

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So, Gerard, I would tell you it's really important that this 9.5%, that's our number, that's our loss forecasting, that's the way we go about measuring the kind of capital we need to have. We're not interested in pushing ourselves to the point where we have a quantitative failure and ask for a mulligan and all those kinds of things. I think it's important that we have a capital planning process with the appropriate governance – I'm talking about the board review – that helps us establish capital based on the risk in our company. Today, we think that risk would indicate 9.5% Common Equity Tier 1 number. We are evaluating, as Grayson mentioned, how we might change that risk profile to help us get the appropriate amount of capital that we have to keep.

Now, your question really is, fine, you're at 9.5% versus – you're at 11%, you've got to go to 9.5%, how quick – what's the pace of change assuming the NPR turns in exactly as it is? And I think that's a great question. We have – we're going to have a lot of thought put into that, especially after learning what we did last year from CCAR submissions. But I do think we need to be real careful about indicating this as some form of panacea. I do think that we need to be prudent, very careful on how we manage this capital, because we have other players, we have shareholders, we have other third parties that are looking at how we think about capital, too. So being very thoughtful about it and looking at that pace. We want to go at the pace that's fair and reasonable for all interested parties. And so a lot of work needs to be done.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Gentlemen, thank you for your insights. I appreciate it.

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

A

Thank you.

Operator: Your next question comes from Vivek Juneja of JPMorgan.

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

A

Good afternoon, Vivek.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Hi. Let me just follow up on that capital discussion a little bit with both of you. David, to your point about, yes, it's going to take time obviously to go from 11% to 9.5% and, Grayson, you've been doing the bolt-on acquisitions, but they've not really used up that much capital and you've done a bunch of these, given how much you're generating. So as you look into 2017 – and I recognize you can't do this right now, but looking to 2017, where is – where do other uses of capital, how would you prioritize them? Returning more than 100% versus, say, bank acquisition?

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

A

Yes. So, Vivek, you're bringing up a good point in terms of capital deployment. Let's go through the how we think about it. First and foremost is organic growth, but it's organic growth on things that add to the return hurdle that we're trying to get to, which is growing to 12% to 14% return on tangible common equity. It's what we laid out at Investor Day. It's where we are today. We're going to update that in December. So to the extent that's not there

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and we continue to generate capital that we're not utilizing, having an appropriate dividend that we have is important to us.

Bolt-on acquisitions have helped. You're right. They don't use – have a tendency to use up a lot of capital. And then outside of that, returning it to the shareholders and exceeding 100% payout ratio has been done. I think that's a learning that we picked up this past year, and we would consider that as well.

You mentioned bank acquisitions. When you look at the valuation for us, right now I'll say we have our CRA issue that we hope gets cleared up, but we really have to get those two things dealt with before we can really start looking at it. And from a valuation standpoint, the math just isn't very supportive of that at this juncture.

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

A

And even then, I think we've been pretty clear. I mean, we're very interested in non-bank bolt-on acquisitions. We've been active in that. There'll come a time when bank-related bolt-on acquisitions matter will be of interest when valuations improve. And I think that we look at that and we try to understand that. I think that right now that's just not our primary focus for – as David mentioned, for a couple of reasons, as well as others.

And so our focus on organic growth, our focus on improving the fundamentals of our company, and our focus on bolt-on acquisitions that, while they don't consume a lot of capital, they also don't add a lot of risk to our company. It's the integration, the synergies that we create. We've got the ability to do that. We're pretty good at it.

We think we could continue to do that. Hopefully over time, we could even increase the pace of this kind of activity. But it doesn't – it's a very manageable risk profile when we execute it this way. Larger acquisitions, obviously, have a very different risk profile. And right now, we're just focused on building a very sustainable franchise value for our shareholders.

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

A

Vivek, I'll add one other thing I should have mentioned is, we do – as we think about our 12% to 14% target in terms of return on tangible common equity, we're working on the new range, as we've just talked about for a little over an hour and a half, but also managing the denominator in terms of our capital base. And getting to our target is important in that calculation. So I think we're all – we get the message. And the pace is – back to Gerard's question, the pace of how we get there just needs to be done in a responsible manner, and we need a little more time to think how that might look.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Okay. I have a small one for Barb. Thank you for that. And, Barb, what was the NPL ratio on energy loans last quarter? Your slide had 12%. What was it this quarter?

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

A

Give me half a second. I'm trying to – 6% --

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

A

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13%.

A

13%.

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

A

13%. Thank you.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Okay. That was with the addition of those five NPLs?

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

A

That's right.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thanks. Thank you.

Operator: We have time for one more question. Your final question comes from the line of Christopher Marinac of FIG Partner Research.

Christopher William Marinac
Analyst, FIG Partners LLC

Q

Thanks. Good afternoon. I guess just kind of going back to part of what Gerard was asking about. Do you think, given the changes on the margin are positive and expenses also a positive heading into the near future, should we be paying more attention to return on tangible equity or return on assets? Which would be more appropriate to kind of gauge progress of Regions?

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

A

So we look at both. When you kind of look at the – regress the return on tangible common and stock price evaluation, it's a pretty tight correlation. So we have a tendency to focus on return on tangible common. It also forces us to make sure we have an appropriate capital base for our business model. So, while ROA is important, you'll see businesses and peers that have more revenue generated from non-balance sheet, non-assets always have a higher ROA, but I think that where the rubber meets the road is really returns on the capital.

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

A

I'd add to that. I think also we monitor pretty close the growth in the absolute value of tangible common equity, not just the return, but how much of our tangible common equity is improving.

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Christopher William Marinac
Analyst, FIG Partners LLC

Q

Great, guys. Thank you very much. I appreciate it.

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

A

Thank you.

Operator: This concludes the question-and-answer session of today's conference. I will now turn the floor back over to management for any additional or closing remarks.

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

No further remarks. Just want to thank you for your time, your participation and your comments, questions. Thank you. We look forward to speaking to you again next quarter.

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

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