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Regions Financial Corp. (RF)

Q2 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

Thank you, Paula. Good morning, and welcome to Regions' second 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 we will reference 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. Factors that may cause actual results to differ materially from expectations 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

Good morning, and thank you for joining our call. Second quarter results reflect continued momentum in 2006 (sic) [2016] and demonstrate that we are successfully executing on our strategic priorities. We are pleased by our continued progress, despite a challenging and somewhat volatile economic backdrop.

For the second quarter, we reported earnings available to common shareholders of $259 million and earnings per share of $0.20. We continue to deliver results in areas we believe are fundamental to future income growth. We expanded our customer base as we grew checking accounts, households, credit cards and wealth relationships.

Our approach to relationship banking and customer service excellence is instrumental to our success, and we are always pleased to receive external recognition of these efforts. In that regard, the Reputation Institute and the American Banker Magazine recently ranked Regions as the most reputable U.S. bank overall, and for the second consecutive year, the most reputable among customers. We are honored to again receive this top ranking, as it recognizes the efforts of all Regions associates in identifying and meeting the needs of our customers and communities we serve. Another outstanding recognition came from Temkin Group, which ranked Regions among the top 10% of companies that rated in the 2016, as we ranked second in the nation for online experience.

Looking further at our results, we achieved total average loan growth of 4% compared to the prior year. Despite market uncertainty, the overall health of the consumer remains a bright spot. To that end, consumer loans increased 5% year-over-year, with loan balances up in every asset category, and our consumer credit metrics

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continue to improve. Consumer net charge-offs decreased 5% from the second quarter last year, non-accrual consumer loans decreased 16%, delinquencies decreased 5%, and troubled debt restructured loans decreased 4%. Active credit cards increased 12% year-over-year, while active debit cards increased 4%. Total transactions on cards increased 6% and total spend is up 5%. Further, average consumer deposits were up 3% year-over-year, including savings deposits were up 9%.

Turning to business lending, average loans increased 3% over the prior year. As we indicated last quarter, we are experiencing some softness in our commercial lending pipelines, still strong but soft. In some areas, customer sentiment continues to reflect less optimism and more uncertainty in the economy. And we've yet to see small business owners really return to the market with confidence to invest and expand.

We were also exercising caution and discipline, as we approach internal concentration risk lending limits with certain segments and certain geographies. And as we highlighted recently in Investor Day, we continue to strengthen our loan portfolio and our focus on migrating credit-only relationships, recycling that capital into more profitable and deeper relationships that result in a better portfolio overall. As a result and as previously disclosed, we expect to track towards the lower end of our 3% to 5% average loan growth for 2016.

Despite softer business loan demand, total adjusted revenue increased 4% over the second quarter of 2015, reflecting the effective execution of our strategic plan to grow and diversify our revenue. Our investments are clearly paying off, as capital markets increased 41% and Wealth Management increased 6% on a year-over-year basis. With respect to market conditions, the global and macroeconomic environment does remain challenging, as such it's critical in this operating environment that we focus on what we can control. To that end, we remain committed and focused on disciplined expense management, and are on pace to achieve our 2016 efficiency and operating goals.

For the first six months of 2016, our adjusted efficiency ratio was 62.3% and we have generated 4% positive operating leverage on an adjusted basis. With respect to energy lending, while our overall oil prices have improved, the low prices continue to create challenges for certain industry sectors, while benefiting others.

On a point-to-point basis, our direct energy loans have declined $324 million or 12% from the first quarter and currently stand at $2.4 billion or 2.9% of total loans. Additionally, we continue to maintain appropriate energy reserves, which now stand at 9.4% of our direct energy exposure, up from 8% last quarter, the percentage increase is primarily due to the decline in direct energy loan balances. Further, we are substantially complete with our spring redeterminations which have, to-date, resulted in a 22% decline in customer borrowing basis.

Turning to capital deployment, we successfully completed the annual Comprehensive Capital Analysis and Review process, or CCAR, and received no objection to our planned capital actions, as, in the last week, our Board of Directors approved a $0.065 dividend on common shares and $640 million share repurchase plan. We remain committed as a team to deploying our capital effectively through organic growth and strategic initiatives that increase revenue or reduce ongoing expenses, while returning an appropriate amount of capital generated to our shareholders.

In closing, our second quarter results reflect the successful execution of our strategic priorities and our continued commitment to our three primary initiatives, which are: rolling and diversifying our revenue streams, practice disciplined expense management, and effectively deploy our capital. These are all integral to our success, and we remain on track to deliver our performance targets.

With that, I'll turn it over to David, who will cover the details for the second quarter.

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David J. Turner, Jr.

Chief Financial Officer & Senior Executive Vice President

Thank you, and good morning, everyone. Let's get started with the balance sheet and a recap of loan growth. Average loan balances totaled $82 billion in the second quarter, up 1% from the previous quarter. Consumer lending had another strong quarter, as almost every category experienced growth, and total production increased 20%. Average consumer loan balances were $31 billion, an increase of $303 million or 1% over the prior quarter. This growth was led by mortgage lending as balances increased $162 million linked-quarter, reflecting a 49% seasonal increase in production.

Indirect auto lending increased $93 million, and production increased 4% during the quarter, as we continue to focus on growing our preferred dealer network. Other indirect lending, which includes point-of-sale initiatives, increased $87 million linked-quarter or 15%.

Turning to the credit card portfolio, average balances increased $16 million from the previous quarter, and our penetration into our existing deposit customer base increased to 17.7%, an improvement of 20 basis points. Total home equity balances decreased $87 million from the previous quarter, as the pace of runoff exceeded production.

As Grayson mentioned, we continue to experience softer pipelines in the commercial space. As a result, total business lending average balances were relatively stable with the previous quarter. Average commercial loans grew $178 million linked-quarter, inclusive of a $64 million decline in average direct energy loans. The net increase in average commercial loans was driven by Corporate Banking as our specialized industry segments added new relationships within technology and defense and financial services. And commitments and line utilization were relatively flat with previous quarter.

Let's take a look at deposits. Total average deposit balances decreased $253 million from the previous quarter. Deposit costs remain near historically low levels at 12 basis points, reflecting the strength of our deposit base. And total funding costs continue to remain low, totaling 29 basis points in the second quarter. With respect to deposits, loan growth expectation provided the opportunity to accelerate our planned reduction of certain deposits within our Wealth Management and Corporate segments, which contributed to the overall decline in deposit balances. Within Wealth Management, certain trust customer deposits, which require collateralization by securities, were moved into other fee income producing customer investments.

Average deposits in the Consumer segment increased $1.2 billion or 2% from the previous quarter, reflecting the strength of our retail franchise, the overall health of the consumer and our ability to grow low cost deposits. Our liquidity position remains solid with the historically low loan-to-deposit ratio of 84%.

Let's see how this all impacted our results. Net interest income and other financing income, on a fully taxable basis, was $869 million, decreasing 2% from the first quarter, but up 4% compared to the prior year. The resulting net interest margin for the quarter was 3.15%. As you recall, the first quarter benefited from items that were not expected to repeat, which partially contributed to the linked-quarter declines in net interest income and other financing income as well as the net interest margin.

Recent long-term debt issuances, lower loan fees, and less favorable credit-related interest recoveries, along with reduced dividends from trading assets that benefited the first quarter, were the primary drivers behind the linked-quarter decrease, and these were partially offset by higher loan balances.

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Non-interest income growth was strong in the second quarter, reflecting our deliberate efforts to grow and diversify non-interest revenue. Total non-interest income increased 2% on an adjusted basis from the first quarter, driven by growth in service charges, mortgage income, and card and ATM fees.

Service charges increased 4% in the second quarter, reflecting the benefit of 2% growth year-to-date in checking accounts again, highlighting the strength of our retail franchise. Mortgage income increased 21% driven by a seasonal increase in production. Of note, within total mortgage production, 75% related to purchase activity and 25% related to refinancing.

Additionally, during the quarter, we entered into an agreement to purchase mortgage servicing rights on a flow basis. As a result, we expect to purchase the rights to service approximately $40 million to $50 million of mortgage loans per month on a go-forward basis.

Card and ATM income increased 4% during the quarter, driven by a 1% increase in active debit cards and an 8% increase in transaction volume. We had another good quarter in capital markets with increased fees from merger and acquisition advisory services. Linked quarter results declined 7% relative to the prior quarter's strong results. The decline was primarily due to reductions in fees generated from the placement of permanent financing for real estate customers and syndicated loan transactions, which were especially strong in the first quarter.

Wealth Management income decreased 3%, primarily due to seasonal decreases in insurance income. This decrease was partially offset by increased investment management and trust fees. Importantly, despite our reduction in the Wealth Management deposits, total assets under administration increased 2% quarter-over-quarter.

Non-interest income was also impacted by market value adjustments related to assets held for certain employee benefits, which increased $20 million compared to the first quarter. However, this has offset salaries and benefits with no impact to pre-tax income. Bank-owned life insurance decreased this quarter, primarily due to $14 million in claims benefits and a gain from an exchange of policies recognized in the first quarter.

Let's move on to expenses. On an adjusted basis, expenses totaled $889 million, representing a 5.5% increase quarter-over-quarter. During the second quarter of 2016, we incurred $22 million of property-related expenses in connection with the consolidation of approximately 60 branches, as well as other occupancy optimization initiatives. These branches are expected to close in the fourth quarter of 2016. Including these 60 branches, Regions has announced the consolidation of approximately 90 branches as part of the company's previously disclosed plans to consolidate 100 branches to 150 branches through 2018, and we continue to expect to be at the higher end of the range.

Total salaries and benefits increased $5 million from the first quarter and as previously noted, includes $20 million in additional expense related to market value adjustments associated with asset sales for certain employee benefits, which are offsetting other non-interest income as I mentioned.

In addition, severance-related expenses declined by $11 million quarter-over-quarter. Excluding the impact of the market value adjustments and severance charges, total salaries and benefits would have declined compared to the first quarter. Year-to-date, staffing levels have declined 4%, serving to lower base salaries and fully offset the impact of the annual merit increase.

Professional and legal expenses increased $8 million primarily due to $3 million in legal and regulatory charges incurred during the second quarter related to the pending settlement of previously disclosed matters as well as

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the impact of a $7 million favorable legal settlement recognized in the first quarter. FDIC insurance assessments decreased $8 million from the previous quarter primarily due to a $6 million refund related to overpayments in prior periods.

As previously disclosed, we expect FDIC insurance assessments to increase by approximately $5 million on a quarterly basis associated with the FDIC surcharge. We anticipate this will be implemented in the third quarter resulting in a quarterly FDIC run rate in the $27 million to $30 million range. Other expenses increased $25 million, including an $11 million increase to the company's reserve for unfunded commitments as well as $9 million of credit related charges associated with other real estate and held for sale loans.

Our adjusted efficiency ratio was 64% in the second quarter and 62.3% year-to-date. As Grayson mentioned, in this uncertain market environment we are focused on what we can control. And to that end, disciplined expense management is paramount. Our plan to eliminate $300 million in core expenses through 2018 is well underway. We're also evaluating opportunities to pull forward some of the identified savings as well as challenging our team to thoughtfully identify additional expense eliminations beyond the $300 million previously announced.

Let's move on to asset quality. Total net charge-offs increased $4 million to $72 million and represented 35 basis points of average loans. The provision for loan losses essentially matched charge-offs in the quarter and our allowance for loan losses as a percent of total loans remained unchanged at 1.41%. Total non-accrual loans, excluding loans held for sale, increased 3% from the first quarter and troubled debt restructured loans or TDRs increased 4%. Total business services criticized loans increased 1%. These increases reflect global market uncertainty and the strength of the U.S. dollar, along with continued volatility in commodity prices.

At quarter end, our loan loss allowance to non-accrual loans or coverage ratio was 112%. We continue to see credit improvement within the consumer portfolio as net charge-offs decreased 24% from the prior quarter. Additionally, consumer TDRs improved linked quarter, while total delinquencies remained relatively stable. Within business services, we experienced $17 million worth of net charge-offs within the energy portfolio during the quarter. Approximately half were attributable to oil and gas and half were attributable to coal.

While oil prices have recently traded around $50 per barrel and are showing signs of stabilization, uncertainty remains. Should prices fall and consistently trade in the $35 to $45 range, we expect additional losses between $50 million and $75 million. However, the timeframe for these losses now extends through 2017, as we expect resolution will take longer for certain customers in the portfolio. And should oil prices average below $25 per barrel through the end of 2017, we would expect incremental losses of $100 million.

In addition, weakness in energy, mining and metals, and agriculture continues to put some pressure on certain commercial durable goods companies. We also continue to monitor investor real estate in energy-related markets. We continue to believe our total allowance for loan losses is adequate to cover inherent losses in these portfolios. Given where we are in the credit cycle and fluctuating commodity prices, volatility in certain credit metrics can be expected, especially related to larger dollar commercial credits.

Just move on to capital and liquidity. During the second quarter, we returned $258 million to shareholders, including the repurchase of $179 million of common stock and $79 million in dividends completing our 2015 CCAR capital plan. As Grayson mentioned, we successfully completed our 2016 CCAR process and received no objection to our planned capital actions. In last week, our Board of Directors approved a $0.065 quarterly dividend on common shares and the $640 million share repurchase plan.

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Under Basel III, the Tier 1 ratio was estimated at 11.6% and the Common Equity Tier 1 ratio was estimated at 10.9%. On a fully phased-in basis, Common Equity Tier 1 was estimated at 10.7%; well above current regulatory minimums.

So let me provide you with an overview of our current expectations for the remainder of 2016. We continue to expect total loan growth in the 3% to 5% range on an average basis relative to the fourth quarter of 2015. Given softer pipelines in the commercial space, we expect to track toward the lower end of that range.

Regarding deposits, softer loan growth expectations coupled with the strategic reduction of certain deposits within our Wealth Management and Corporate Banking segments will result in total average deposits remaining relatively stable with fourth quarter 2015 average balances. Our expectation for net interest income and other financing income remains unchanged. Assuming no rate increases for the remainder of 2016, we expect to be at the midpoint of our 2% to 4% range.

As a result of our investments, we continue to expect to grow adjusted non-interest income in the 4% to 6% range on a full year basis. And given our year-to-date performance, we would expect to be at the higher end of that range. Our plan to eliminate $300 million of core expenses is on track and we continue to expect to achieve 35% to 45% in 2016. Therefore, total adjusted non-interest expenses in 2016 are expected to be flat to up modestly from 2015.

We also expect to achieve a full-year adjusted efficiency ratio of less than 63% and adjusted positive operating leverage in the 2% to 4% range in 2016. Full year net charge-offs should be in the 25 basis point to 35 basis point range, and given the volatility and uncertainty in the energy sector, we continue to expect to be at the top end of that range.

So in closing, we are pleased with our second quarter performance and believe our results demonstrate that we are effectively executing our strategic plan in the context of a difficult operating environment. We look forward to updating you on our progress throughout the remainder of the year as we continue to build sustainable franchise value.

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

Dana W. Nolan

Executive Vice President - Head of Investor Relations

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 in order to accommodate as many participants as possible. We will now open the line for your 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 Marty Mosby of Vining Sparks.

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

A

Good morning, Marty.

Marty Mosby
Vining Sparks IBG LP

Q

Good morning. I want to ask a question about the other expenses, not that they were unusual, but there were some credit related to the unfunded commitments as well as some other credit related expenses. It looked about $20 million higher than the run rate. Just wondered if that was something that elevated that this particular quarter?

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

A

Yeah, Marty, this is David. So from time-to-time, we'll have some credits that go sideways on us. In this particular quarter, we had really one large credit in the unfunded commitment that caused $11 million increase there, and the charge for that we run through non-interest expense. And you'll see over quarters, the volatility that can have, pluses and minuses. We expected that credit would fund in the third quarter, but we believed it was important for us to continue to have an [ph] un-fund (27:37) reserve for that today.

From an OREO and held for sales standpoint, again just a couple of credits, they happen to be large and we had some write-downs that we believed needed to take place. So we had valuation adjustments in total of about $9 million. So you're spot on between the two that was about $20 million of the charge that we had to take during the quarter.

Marty Mosby
Vining Sparks IBG LP

Q

Thank you about that. And then your tangible book value growth, been great, about 2% or better consistent growth. As you're looking at creating shareholder value, one of the things is probably what you've been able to de-risk because just getting credit from the tangible book value growth would be an upward momentum for the overall valuations. So just wanted to see if – as you think about where you're at today versus where you were at as a win in the last downturn, what makes Regions different from just a risk profile? Significant changes have been able to address that should at least make investors comfortable with tangible book value.

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

A

Sure. So over the past six years we've made a lot of changes in people and process. Content of our whole balance sheet has changed dramatically. The most obvious one is a decline in investor real estate which represented almost 30% of our loan portfolio at one time. Today it's about, call it, 9% – right at 9%. The credit discipline that we have with regards to how we approach business is very different and we feel good we have our hands around our loan portfolio.

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Energy. Energy has been a challenge for our industry and those of us that participate in it, but our concentration to risk management program that we have in place has reduced the negative impact we would otherwise have had. Being the largest bank headquartered in the Gulf states, we have now about 3% of our loan portfolio in energy and we've talked about the reserves, a 9.4% reserve. So we believe we have that covered.

There is some volatility and uncertainty there. We feel like we're on top of that. As we think about our commitment to continue to grow our cash flow, our PPNR, look at the investments that we've made over time, those investments are paying off as we've continued to grow and diversify our revenue stream and we've had a fairly consistent margin, if you look at that.

And then, I'll wrap up with expense management. We have a $300 million target out there. We said we'd take 35% to 45% of that in the first year. We're on track where we want to be. And I gave you guidance as to where we thought we'd finish the year. So it's a very different regions and a very different approach to business and the stability of growth in tangible book value. We've been leveraging our earnings well, and returning mid-90% of our capital back to our shareholders in the form of a dividend, around 30% of that earnings, and 60%-plus in terms of share buybacks. So we think we're deploying our capital effectively. So good business, good markets, good customers, and executing against the strategic plan that we laid out in October for our board and at Investor Day.

Marty Mosby
Vining Sparks IBG LP

Q

Thanks, David.

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

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

A

Good morning, Jennifer.

Jennifer Demba
SunTrust Robinson Humphrey, Inc.

Q

Good morning. Thanks for taking my question. Question on your capital markets revenue. What do you think the potential is for this fee line over the next two years to three years. It's been growing at a rapid pace for a few quarters now?

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

A

Yeah. I mean as David mentioned earlier, we continue to see some softness in our wholesale sales pipelines. And if you look at it strategically, what we tried to do with that business is to build out a lot of the product offerings we have primarily in capital markets, but also in treasury management, so that we can generate a very reasonable return on invested capital in that business. And the capital markets group is a place that we've made significant investments. We continue to believe that those have been thoughtful and smart investments. We had demonstrated very strong growth this year. We continue to challenge the team in terms of what the growth capabilities are of that activity. We're coming from a relatively low base. So the percentages look remarkably high but we have not publicly stated a percentage increase goal, but we do believe strongly and confidently that that's a business that we can continue to grow over time at an above-rate level to other parts of our business.

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Jennifer Demba
SunTrust Robinson Humphrey, Inc.

Q

Okay. Thank you.

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

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

A

Hey, Geoffrey.

Geoffrey Elliott
Autonomous Research LLP

Q

Hi. Good morning. Thank you for taking the question. When I look at the criticized loan balances, you're giving overall, on page eight, I see an increase. And then, when I look at page 12, just specifically the energy balances, I see it decrease. So I wondered if you could elaborate on what's driving the increase outside of energy.

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

A

Yeah. This is Barb Godin. So energy, as you said, did go down. We saw some other movement. As we look at some of the other areas that we have considered to be a little soft that would be agriculture, some transportation and primary metals. So we're keeping an eye on that. We're being very cautious in those categories. We're watching them. And as we see signs that there's any deterioration, we're immediately moving them to a special mentioned category. And so, that accounted for the increase there.

Geoffrey Elliott
Autonomous Research LLP

Q

Thank you. And then just a quick follow-up. I didn't catch earlier, but I think you said the non-interest income growth you thought should be at the high-end of the 4% to 6% range. I just wanted to check I had that right?

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

A

That's right. Just taking kind of where we are today and looking at the investments we made and what's in the pipeline, we feel that we will most likely be at the higher-end of that. We'll give you a better guidance one more quarter out, but we feel confident not to be able to lean towards the higher end of the range.

Geoffrey Elliott
Autonomous Research LLP

Q

Great. Thank you.

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

A

Thank you.

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

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

A

Hello, Matt.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Good morning. Thanks for taking my question. David, maybe a question for you. Just following up on your comments about the $300 million cost reduction and the 35% to 40% specifically you're targeting for this year. Is it reasonable to assume that the pace of that 35% to 40% reduction will be largely back-end loaded or could it be perhaps a bit more evenly spaced over the course of this year?

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

A

Well, you can have – we haven't placed it in any given quarter. We really are trying to guide more to the full year than any given quarter. You can have at times spikes in expense from one quarter to the next, but we'd rather just stick with the guidance for the full year of being where expenses would be flat to up modestly from 2015.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Okay. And then just on the – it sounds like a little bit of softness in the commercial pipelines, particularly in C&I. Outside of energy, are there specifics industries where you're seeing particular softeners, or is it more of a broad-based greater level of caution on your borrowers' part given the economic uncertainty?

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

A

I mean I think where we try to compete is in the lower end of the commercial market. And you've seen a lot of our competitors demonstrate growth, a lot of that growth has been in the higher end of commercial into the corporate space. But when you look at that middle market C&I customer, we're seeing a lower level of demand for lending to support capital spending. I would tell you that energy is an obvious place where that has occurred.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Sure.

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

A

But you do see it. You do see that spread across a number of different commercial industries as there's been obviously a strengthening of the U.S. dollar and some uncertainty created by a lot of events in both globally and domestically. And so I wouldn't say it's limited to one particular industry. It seems to be more broad-based than that, but if you look at credit quality, commercial's still very good. We've had a really good experience now for several quarters in a row. We still expect it be good but it's modestly soft, modestly weaker than what we saw a quarter ago, and at the same time, we're just not seeing the new and renewed production that we were seeing this time last year.

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Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Okay. That's helpful. And, David, maybe just another quick one for you. In terms of the bank-owned life insurance numbers, you mentioned a couple of reasons why that had moved around over the last couple of quarters. I guess, I'm just trying to get level set on what a reasonable run rate would be for the second half of the year?

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

A

Yeah. So the first quarter did benefit from a couple of things. We exchanged policy into a different product and we also...

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Right.

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

A

... had a [indiscernible] (38:26). Where we are right now is about where you ought to expect that for the remainder of the year.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Okay. Thank you very much.

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

A

Thank you.

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

Ken Usdin
Jefferies LLC

Q

Hi. Good morning. On net interest income, I wanted us to understand, you've got the purposeful decline on the wholesale balances, so the balance sheet looks to have shrunk and with the offset being a little bit better NIM, can you just walk us through how you kind of expect that trade-off to go going forward? Do we see not as much growth in earning assets, but a lesser decline in the NIM in terms of growing NII?

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

A

Well, certainly from a NIM standpoint, we're really trying to get growth in NII, but NIM will be continued pressure if this rate environment stays where it is, and I would expect you can have 4 to 6 more points of compressions through the remainder of the year.

But as we think about growing NII, we do it from a couple different spots: one, growing earning assets, which is really on the funding side, the deposit side, and putting that growth in good solid loan growth where we can get

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compensated for the risks that we're taking, where we can get compensated for having a full customer relationship versus just running out the balance sheet from a credit-only standpoint. It's very hard to make money if you're just making loans only.

So we're challenging our teams where we have a relationship that's a credit-only relationship, to figure out how we recycle that capital into a more fulsome relationship with the customer. So just because we don't have the loan growth doesn't mean we can't continue to grow NII if we execute that program appropriately. So that's kind of how we think about NII going forward.

Ken Usdin
Jefferies LLC

Q

Yeah. And...

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

A

Well...

Ken Usdin
Jefferies LLC

Q

Go ahead, Grayson. Sorry.

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

A

And I'd just reiterate, we continue to see solid loan growth opportunities on the consumer side of our balance sheet. We expect that to continue. We don't see a reason at this point in time to not believe that continues and the health of that consumer/customer continues to be remarkably strong.

Now, on the Wholesale side, our focus continues to be in the lower end of that commercial middle market space, and we're trying to be much more rigorous, much more thoughtful, and certainly more disciplined at this point in the credit cycle to make sure that what we're putting on our balance sheet makes sense, that it has a reasonable return and a full relationship, as David said.

Ken Usdin
Jefferies LLC

Q

Okay. And my just one follow-up on that, David. So getting to 3% year-over-year NII growth is almost baked in the cake even if you don't grow it sequentially from here, but are you confident though that you still can envision an X rates growth in NII from the second quarter point?

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

A

Well, again, we've landed on 3% for the full year. We're working hard to take where we are right now to continue to grow. It's obviously very challenging given the rate environment; what's rolling off versus what's going on, flattening of the yield curve. So we have some reinvestment risk with regards to the securities portfolio, but we think if we will execute, we can continue to have some modest growth in NII, and again, we believe strongly in the 3% growth for the year.

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Ken Usdin
Jefferies LLC

Q

Okay. Got it. Thank you.

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

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

A

Hello, David.

David Eads
UBS Securities LLC

Q

Hi. Good morning. Maybe just following up on the last point about the reinvestment risk in AFS portfolio. With the tenure where it is, is there any change to your policy? I mean you're basically just looking to replace maturities and pay-downs at current prices. Anything you'd look to do to change on that perspective?

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

A

Yeah. We don't have any major change anticipated. We haven't extended the duration. We're a little over three years right now. It's been that way for a while. We don't look to make that change. We have the risk profile in the securities book like we want it to be. So we haven't looked for a lot of wholesale changes from basically the mortgage-backed that we have there today.

So as you are pointing correctly, the risk to us is that reinvestment yield as the 10-year continues to have pressure on us, we'll put pressure on our return on the securities book, but we don't believe the risk of trying to change that dramatically is worth it to us right now. So you've kind of answered, I think, your own question.

David Eads
UBS Securities LLC

Q

Right. That makes perfect sense. And maybe on a related point, it's a good quarter for mortgage revenues. You guys made the point that it was mostly purchase related. Do you have expectations for how that business is going to shake out over the next couple of quarters and whether it gets a little bit more refi-heavy and whether I guess revenues can kind of stay in your – stay nearly seasonally high levels for a couple of quarters?

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

A

Yeah. I mean I think that we were pleased with performance of our mortgage team this quarter. Again the mix of business that we placed on the books this quarter is about 75% repurchased and about 25% refinanced or purchase and refinanced. We do expect to have a good third quarter based on what we're seeing today. We have seen a shift in the application volume. I would tell you that instead of being about 75%-25%, it appears to be shifting to more 60%-40% in terms of purchased versus refinanced. So we should see that shift in this quarter, but I think we'll have a good quarter. Traditionally, if you look at our numbers, second quarter and third quarter are always our strongest mortgage origination quarters. So absent any change that we don't see today, we think we already have good progress going forward.

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David Eads
UBS Securities LLC

Q

Great. Thanks for taking the question.

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

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

A

Hello, Stephen.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Hey, guys. Appreciate you taking the time here. I had a question for you on the previously announced relationship with Avant and where that's at, and if there's any changes given kind of their volume cuts and their business or what that's going to look like for you guys moving forward?

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

A

Yeah. So Avant is still in the early stages. We'll launch that in August. So it's premature for us to comment. We think it can be accretive to us over time, but the way we're treating some of these investments that we're making is we're not taking a lot of risk. We're trying some things. We're seeing we can learn. We're seeing how we can better serve our existing customer base with these opportunities. So we think it'll work for us, but again, too early to tell. We'll update you as we go through the third quarter and into the fourth quarter.

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

A

I mean, we continue to get good feedback from our customers on our online experience. And as just we mentioned earlier in a call, we've gotten some recent recognition in that regard and ironically we're in the process, even as we speak, of refreshing our online and mobile experiences for our customers. We're launching that as we speak and then Avant will be in August as David said. We think it's just one more way of trying to provide a better experience for our customers in both the online and mobile channels, but it'll be incremental to what we're doing. Good consumer numbers. I think we were extremely pleased overall with consumer numbers this quarter across all channels. One of the better quarters we've had.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Sounds good, yeah. And I guess maybe as a follow-up, do you have any trepidation on either – from the standpoint of giving away customer data or losing customer contact in relationship such as this? And also just you mentioned the growth in consumer as a whole. Any trepidation there in terms of increasing that exposure and what ultimate losses could be on the consumer side, even as I know credit metrics on the consumer side have been good here as of late?

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

A

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I mean, well first of all, the foundation of our business is built of customer trust. Without customer trust, our business model doesn't work. And so we are very sensitive to anything we do that involves customer data and the privacy of that data, the confidentiality and protection of that data. So we have very extensive risk management reviews. Our due diligence process is very rigorous and will continue to be. That being said, cyber security is an area that we're all challenged with today, but spending an awful lot of resource and time on it, but there's nothing more important to us than the trust of our customers with their information and their assets.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Okay. Thanks, guys.

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

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

A

Hello, Michael.

Michael Rose
Raymond James & Associates, Inc.

Q

Hey, hi. Good morning. David just one for you. Just going back to energy, you laid out the scenario of oil was $35 to $45, but what if we're contracting above that into the back half of the year, what would that imply for losses and maybe any updated commentary into 2017?

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

A

Yeah. So we have as you now see reserves of about 9.4%. Those reserves are established based in large part due to the risk ratings we assigned. They come from our work and our credit team's work and also evaluated by our regulatory supervisors. In terms of what ultimate losses are, we'll have to see. If we continue to get stabilization in higher oil price and that reduces our pressure and risk of ultimate charge-offs, but I would say that given the volatility that we see in prices, it'd be premature to see how those reserves would come back into income in the short term. I think we need to let that play out over a little longer period of time.

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

A

This is Barbara. [indiscernible] (49:10) Michael that with oil leaving at $50 or higher a barrel that certainly helps the E&P companies first, but the oilfield services companies, they tend to lag. So again that is a reason for us putting us the $50 to $75 between now and the end of next year.

Michael Rose
Raymond James & Associates, Inc.

Q

Fair enough. Maybe just a quick follow-up, provision net charge-offs this quarter. I obviously understand volatility with oil and lag from service companies. But is it the way to think about that, is that provision should match pretty closely to charge-offs moving forward?

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

A

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We have a process that we go through absent anything unusual that's a pretty good yes. That being said, as credit continues to improve across the board and risk rating is changed, then you don't have to provide for those losses. And that would be the indicator of where a provision could be less than charge-offs. So we need to let our model run and trying to forecast that out is probably not the best thing for us to do.

Michael Rose
Raymond James & Associates, Inc.

Q

Understood. Thanks for taking my questions, guys.

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

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

A

Good morning, Erika.

Erika P. Najarian
Bank of America Merrill Lynch

Q

Good morning. You had few of your peers give guidance on dollar expenses beyond 2016, in fact going out all the way out to 2018 in a bid to tell investors that they can support efficiency gains without rates. And I'm wondering as we think about 2017, you're guiding that we should enter the year with a base, an absolute expense base of let's say $3.45 billion.

And I'm wondering if – how you're thinking about some of the cost savings that you have already identified to go into that 2017 number, and whether they can overwhelm some of the investments. In other words, is there room to cut that $3.45 billion number to support efficiency, if we don't get the help from the rate environment?

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

A

So, Erika, it's a good question. I tried to address a little bit of that in the prepared comments. So when we – so we have a $300 million expense elimination program, we're on track with that. We're really are challenging ourselves. We do think of couple of things. One, how do we – some of those savings actually, due to our model, start in 2018. And so the question is, what can we do that's prudent, make sense to move into 2017. And that will take some work, we'll come back as we get later in the year and start giving you a little better guidance into 2017. We'll give you an update on that. The second would be – there is a – we had a lot of rationale that went around the $300 million. It was roughly 9% of our expense base, but we're going to go back and challenge ourselves to think through how we might change that over time.

Again, we need to be very thoughtful. We need to make sure we don't benefit the short-term at the expense of the long-term franchise building that we're trying to do. We want sustainable franchise value, we don't want just short-term. So, it gets trickier as we start thinking in these terms, but we believe rates – and you have to have a mindset that rates are going to be lower for longer and this is something we can't control. So, we have more work to do here and we're looking forward to the challenge.

Erika P. Najarian
Bank of America Merrill Lynch

Q

Okay.

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

A

We've been in this environment for good long while and we've learned how to manage through. We've had to really defend our margin and defend the credit culture that we're trying to build in terms of how we grow and build our loan portfolio and managing expenses in this lower for longer environment, so it's got to be a skill set that we continue to exercise and deploy. We've been very aggressive on branch consolidations. We think we know how to do that and do it well, but I think that, as David said, is that in a lower than longer forecast and we have to go back and just continue to re-challenge ourselves and redefine how we manage through this for a longer period of time.

Erika P. Najarian
Bank of America Merrill Lynch

Q

Thank you. And just as a follow-up question to Barb, you mentioned something about how energy prices impact different parts of your energy portfolio from a different timing perspective. And the question really here is, investors are starting to wonder what type of oil price level do we need to see to see that 9.4% reserve ratio start getting released or going down. Appreciating that this reserve is built on a loan by loan basis, but is there an external factor that we can look to, to say, okay, that's now done and we can now expect to release some of those reserves into the rest of the book?

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

A

Yeah. Erika, I think you hit the nail on the head relative to the reserve is made up of different grouping. Of course, E&P, as I said, will benefit from higher oil prices where we see them in the $60 a barrel to $70 a barrel range. It's great for the E&P companies, but again, even at that level, oilfield services companies will continue to be challenged. It takes them longer to restructure and get back on their feet, so again the extended tail on the oilfield services and as we think of our provision, roughly two-thirds of our provision right now is established against the oilfield services subsector in our book.

Erika P. Najarian
Bank of America Merrill Lynch

Q

Okay. Thank you. That was helpful.

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

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

A

Hello, John.

John Pancari
Evercore Group LLC

Q

Good morning. Regarding the loan growth on the Commercial side, I know you indicated some of the weakening of the pipeline, but also some of the intentional pullback in the single relationship credit. How would you split that up in terms of the impact on second quarter ended period loan growth from the Commercial side? How much of that weaker than expected – or how much of that weakness, should we say, came from the intentional pullback versus the softening demand?

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

A

Yeah, I mean, that's a great question. It's, one, we've spent some time ourselves internally sort of discussing and debating. And clearly, part of the weakness we're seeing is just general market demand or credit. And if you look at top of company and domestic U.S. numbers, the level of fixed capital spending by wholesale customers continues to be below historical proportions. And so we're seeing that in demand for credit.

But at the same time, you also hear us talking about making sure that we've got full relationships, and we're getting paid a reasonable return for providing banking services to our clients, so we need a full relationship to do that. The return on our credit-only relationship is just not sufficient. But we also have been very disciplined in making sure that we have diversity in our balance sheet. And so there are certain asset categories that our risk appetite is fulfilled on. And so we've been more judicious about not adding more of that product to our balance sheet and we're absolutely committed to staying diversified.

I think if you look at it today, we would say it's about half and half, about half of it's market, and about half of it is disciplines that we are invoking. I'd also remind you that, when you look at our loan growth for this quarter, keep in mind that the reduction in energy loans that we've achieved over the past quarter has been a – there is a story there that without that reduction in energy, growth in our Wholesale book would have been much stronger.

John Pancari
Evercore Group LLC

Q

Okay. That's helpful. And then, real quick, Barb, on credit. Did you say that both the criticized balance increase as well as the NPA increase were attributable to the other areas that you cited; agriculture, metals, and transportation?

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

A

No, NPA was primarily an energy story…

John Pancari
Evercore Group LLC

Q

Okay.

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

A

…besides just the other groups that I told you about.

John Pancari
Evercore Group LLC

Q

Okay. Got it, got it. All right. And then, lastly, in terms of the margin impact of putting on less of the more thinly price relationships that are single relationships type of credits that you're deemphasizing, just trying to put a number around it or in terms of yield, at what yields are some of those loans running off that you're deemphasizing, that is single relationship? And then, how does that compare to new production yield [ph] somewhat (58:36) you are putting on your book?

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

A

Well. Really, it just depends, John, in terms of different products. In the C&I space, we haven't seen spreads change dramatically there, but if you're 2.25% over, you're working against yourself, that portfolio yielding yields today about 3.5%. And so, as we think about how to combat some of this, one is to get deeper relationship, where we're not having to look just at spread, because the spread is only a component part of the income we get from the customer base as the other NIR sources that help round it out. So, if, in fact, we had a lower spread asset with a poor relationship, we can deal with that. It's having a low spread without the relationship, that's a problem.

So, I think that also how to combat this would be the consumer growth. We grew consumer loans about $300 million. We've had nice production in Consumer, where we're getting paid for that risk and that's helping to combat the downward pressure on loan yields. So, our loan yields from the first quarter were only down 2 basis points, part of that's the mix shift and the remixing of business that we're trying to make in our total balance sheet to be more profitable and to get the better return to our shareholders.

John Pancari
Evercore Group LLC

Q

Okay. Got it. Thanks, David.

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

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

A

Hello, Paul.

Paul J. Miller
FBR Capital Markets & Co.

Q

Yeah. Thank you very much. Most of my questions have been answered, but I do have one on non-interest income. You gave a – I think, a range of 5% growth there over the – and over the last year, most of your growth has come from either card and ATM fees or capital markets. Is that what we should be modeling in? Is that where most of the growth is going to come from or is there some other categories that you've been investing and you should start seeing some growth there?

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

A

No, I think, if you look at that, we've made lots of investments in capital markets. You're seeing the growth there. But also, in terms of service charges and credit card, ATM card kind of growth, all that's really coming from poor consumer household growth. We're seeing better consumer growth across the communities we serve more broadly than we've seen in the past. We really are pleased with the progress we've made in the customer experience in our Consumer business, and the results really are starting to come through. And we think that that continues to be a good story.

Additionally, we've made several investments in our Wealth Management offerings. Wealth Management had a good quarter this quarter. We think that continues and has the prospect of even improving. So, overall, very good story this quarter.

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Paul J. Miller
FBR Capital Markets & Co.
Q

And you're saying – where are you seeing most of the growth? I know you've invested in Florida pretty heavily over the years. Is it coming across your geographic footprint, or is it coming in certain states?

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

No, that's more broad than it's been in the past. And you're correct and, historically, we had a very strong growth out of the state of Florida. You know that Florida continues to be a very critical market for our franchise, but growth is much more broad than it's ever been historically in the company. That's been purposeful on our part. We very much try to make sure that we're not only diversifying our business by product, but we're diversifying by geography. And we've made very conscious investments to improve the production of our Consumer and our Wealth Management business, as well as wholesale across all of the communities that we serve.

Paul J. Miller
FBR Capital Markets & Co.
Q

Okay. Hey, thank you very much, guys.

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

Thank you.

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

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

Hey, guys.

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

Hi, Matt. Hello.

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

Any update on the CRA downgrade from earlier this year in terms of what you're doing to remediate that and if there's any impact it's having on kind of the day to day operations of you, guys?

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

Yeah, Matt. This is David. So, we have to go back to kind of the exam that we had and the results. Our core CRA program continues to be robust. We have a lot of assessment areas, especially relative to anybody else in the country, and we do a good job. Our team is really committed to the customers and the communities that we serve, and we feel like we're doing a pretty good job there.

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We did have an issue that was outstanding from another regulatory agency was considered. And so we're going through – we have to go through another exam cycle for that to get cleared up, the timing of which is completely dependent on our regulatory supervisors, and we believe we've done everything we need to to continue to work through this and we hope that the conclusion is favorable, when that is concluded upon by our regulatory supervisors.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Okay. And then, just separately, if we look at the indirect consumer bucket, I think, which includes the POS loans, the $600 million to $700 million of loans, you've had a good growth there. It seems like there is kind of the typical beginning of the seasoning of that portfolio from a credit quality perspective. Obviously, very small numbers, but do you have a sense of what losses in that book may get to? It's a good yielding book and you've been growing it a lot.

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

A

I mean, when you look at the indirect portfolio, we've been growing it quite steadily. We started off from a relatively small base. We've been very selective on where we participate in that market. We've been very selective in the auto space and we've been very selective in a number of point of sale spaces that we participate in. And we continue to test the production that's going on the book. And we do believe that expected losses in this portfolio, we're targeting them to be less than 2.5%.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Okay. All right. Thanks for taking my questions.

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

A

Thank you.

Operator: Your next question comes from Vivek Juneja of JP Morgan.

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

A

Good morning.

Vivek Juneja
JPMorgan Securities LLC

Q

Hi. Good morning. Couple of questions, please. MBS premium amortization, can you just give us – it's a nitpicky one – what was the amount in the second quarter? Where do you expect it to go in the third quarter?

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

A

Yeah. So, Vivek, this is – we've had kind of the mid-$30 millions in terms of premium amortization. We do expect that to increase modestly over the second half of the year, maybe up $5 million to $7 million each of the quarters, third and fourth quarters, just dependent on prepayments that come in. We see the refinance activity that's

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occurring through pipelines in that volume for us. So we can project that out a little bit in terms of prepayment speeds and expect it will pick up just a bit.

Now, that being said, that is embedded in our forecast of our NII growth, which we say would be somewhere in the – right at the 3% range for the year.

Vivek Juneja
JPMorgan Securities LLC

Q

Okay. Great. So, it didn't go up, David, in the second quarter? You are waiting for prepayments to show the path before you increase it in the third quarter?

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

A

That's correct.

Vivek Juneja
JPMorgan Securities LLC

Q

Okay. And capital, a bigger picture question, how do you get it down? This is more for both of you. You've got such a high level, close to 100% pay-out, what do you do to bring that down, because obviously loan growth is not – you're not growing that any faster based on all of the other factors that you're taking into account?

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

A

Yeah. So, we'd like, over time, we have mentioned, to get to our capital targets and bring this down over time. If you look at the CCAR, continuing to address a couple of things there. One, the stresses in each of the portfolios, we have some learnings that we can take from that as we re-shape certain of our businesses, take out risk, which then reduces the amount of capital you need to have, in particular, in the stressed environment.

We did not have a go over 100% of earnings. We did have a couple of regional players that did for the first time. For us, we want to make sure we optimize our capital structure in terms of the nature of the components, so – preferred stock and common stock and the like to make sure that that's optimized and, over time, we will do that to reduce our cost of equity. But I think working on the stresses inherent the balance sheet, which we have done, and you've seen that come down in places like commercial real estate. Losses came down quite dramatically, but still high. And so how do we change our business model over time to reduce the amount of capital we have to have, so that we can either put it to work, if there is opportunities to grow loans and when there is not, returning that capital to our shareholders, especially when we trade at tangible book value.

Vivek Juneja
JPMorgan Securities LLC

Q

Okay. All right. Thank you.

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

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

A

Hello, Gerard.

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Gerard Cassidy
RBC Capital Markets LLC

Q

Hi, Grayson. Hi, David. Kind of a question, your loan-to-deposit ratio upticked a little bit this quarter to 84%. What's the optimal level for that loan-to-deposit ratio for you folks, and how do you plan to reach that level?

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

A

Yeah, Gerard, it's a good question. So, we've been one of the lower loan-to-deposit ratios. I think getting up a few more points perhaps in the upper 80%s, lower 90%s is a right place for us to be. In good old days, it would be 100%, when you could rely on wholesale funding, and that you could take money out every night, and that really – that market doesn't operate that way. So, I would say upper 80%s, lower 90%s.

I do think the construct of the deposits we have, given the LCR framework, deposits – certain deposits aren't as useful to us, and in particular, as we think about liquidity, those deposits that are collateralized provide a little liquidity value to us, and that value really stems from the diversification of funding more so than the actual liquidity, because we're having to post up our best securities for it. So, I think you'll see that drift up a bit over time. The pace of which is hard to tell.

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

A

And, Gerard, if you look at our deposit this quarter, core deposit is really a very good story. We created a much more favorable mix of deposits and we've reduced some of our deposits, to David's point, that are less attractive under LCR, but also less attractive at the end of the day from a liquidity perspective.

And so, while our deposits were down modestly at the top of the company this quarter, actually core deposits, core deposits that we find attractive were actually up and the liquidity of the company actually improved. And so, we continue to believe that the core value of this franchise really is as a deposit gatherer. And we continue to have a very good story there and a good message back and so I think that, to David's point, there was a time when you could fund loans in a very different way. But today, the best way to fund loans is with core deposits and we think in that high-80%s, low-90%s would optimize the earnings power of this company, but we're going to need good solid organic loan growth to make that occur.

Gerard Cassidy
RBC Capital Markets LLC

Q

Thank you. And regarding the consolidation of the branches, have you guys done any work to measure when you consolidate or shut down a branch, what percentage of the customers stay with you and would...

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

A

Yeah. Absolutely.

Gerard Cassidy
RBC Capital Markets LLC

Q

Yeah. Go ahead. Yeah. I was going to follow up, but go ahead, David.

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

A

No. I mean, go ahead and finish.

Gerard Cassidy
RBC Capital Markets LLC

Q

Yeah, okay. And then, with the advent of the mobile technology you all have today versus 15 years ago, when if you shut down some branches, the numbers may have been different. Have you noticed is there a differential, meaning you're keeping more of them today because of the mobile technology?

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

A

Yeah. I think that, one is, since – I guess, since 2007, 2008, we've closed and consolidated over 500 branch offices. We have a very good process for that. I think that, from our perspective, we continue to see that how you – the process for consolidating those offices really have to do a lot with customer communication, and how you equip and train and staff the receiving offices. And to the extent if the receiving offices is a relatively close proximity and we would say that close proximities within 10 miles of the other branch, that you're seeing very, very good success with virtually no losses in customers in that regard.

We do think that the alternative channels, ATM, call center, mobile, online, all of those other channels provide us an opportunity to provide strong connectivity to your customer and while we've seen branches losing traffic in the sort of 3% to 5% a year range, we've seen tremendous growth in the online and mobile channel. So we think continuing to add functionality there enhances the customer experience and enhances the retention of those customers. But I would say all of it has to be done, you have to do all those things well in order to have a successful consolidation. But great question, it's one, that we continue to adjust and fine-tune on a regular basis.

Gerard Cassidy
RBC Capital Markets LLC

Q

Gentlemen, thank you.

Operator: We have time for one more question. Your final question comes from Christopher Marinac of FIG Partners.

Christopher William Marinac
FIG Partners LLC

Q

Thanks. Good afternoon. I appreciate the question. I wanted to ask about slide 14, which has got into the loan split in Texas and Louisiana. I guess I'm curious with energy prices starting to stabilize, does that pretend that you would want to see those markets be stable in terms of loan balances or could we actually see growth still on those areas?

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

A

Well, I think if you look at Texas and Louisiana on those slides, very important markets for us, and a much more diversified market than you would have seen a few years ago. And even though, we're seeing all these stress our customers did are directly or indirectly tied to the energy business, we're seeing an awful lot of strength than other

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industries, we're seeing an awful lot of opportunity to still provide banking services in those markets. And so, we're still very, very confident about our ability to grow there.

Christopher William Marinac
FIG Partners LLC

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Great, Grayson. Thank you very much for the background.

Operator: This concludes the question and answer session of today's conference. I will now turn the floor back over to Mr. Hall for closing remarks.

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

No, well, thank you very much for your attendance and participation today. I really appreciate your questions and your interest. And thank you. We stand adjourned.

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

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