Regions Financial Corporation (RF) CEO John Turner on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-22-19 Earnings Summary

Press Release *10-Q* *Slides*

EPS of $0.3925 beats by $0.00 | Revenue of $1.51B (2.31% Y/Y) beats by $23.19M

Earning Call Audio

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Regions Financial Corporation (NYSE:RF) Q3 2019 Results Conference Call October 22, 2019 11:00 AM ET

Company Participants

Dana Nolan - Investor Relations

John Turner - President and Chief Executive Officer

David Turner - Senior Executive Vice President and Chief Financial Officer

John Owen - Senior Executive Vice President Chief Operating Officer

Barb Godin - Chief Credit Officer

Ronald Smith - Senior Executive Vice President, Chief Operating Officer

Conference Call Participants

Ryan Nash - Goldman Sachs

Matt O'Connor - Deutsche Bank

Ken Usdin - Jefferies

Betsy Graseck - Morgan Stanley

John Pancari - Evercore ISI

Erika Najarian - Bank of America

Saul Martinez - UBS

Gerard Cassidy - RBC

Brian Foran - Autonomous

Christopher Marinac - Janney Montgomery Scott

Stephen Scouten - Sandler O'Neill

Operator

Good morning. And welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Shelby, and I'll be your operator for today's call [Operator Instructions].

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

Dana Nolan

Thank you, Shelby. Welcome to Regions' third quarter 2019 earnings conference call. John Turner will provide highlights of our financial performance and David Turner, will take you through an overview of the quarter. Earnings related documents, including forward-looking statements, are available under the Investor Relations section of our Web site. These disclosures cover our presentation materials, prepared comments, as well as the Q&A segment of today's call.

With that, I will now turn the call over to John.

John Turner

Thank you, Dana. And thank you all for joining our call today. This morning, we reported earnings from continuing operations of $385 million, a 9% increase over the third quarter of last year, resulting in earnings per share of $0.39, an increase of 22% over the prior-year.

This quarter, we also delivered the highest pre-tax pre-provision income that we produced in nearly a decade, while generating 3% adjusted positive operating leverage year-to-date. All-in-all, despite lower interest rates and significant market volatility, it was a very solid quarter.

Over the last two years, our core messaging has reflected our intention to generate consistent and sustainable long-term performance through all phases of the economic cycle. We've been planning for the time when we would no longer benefit from a rising rate environment, and when credit would begin to normalize.

Since late 2017, we began taking incremental actions to reduce our interest rate risk, build a stronger and more resilient balance sheet and improve returns on capital. We executed a robust hedging strategy that will protect us in a declining rate environment, and allows us to maintain a healthy and stable margin without having to stretch for loan growth.

With respect to credit, our team has spent the better part of the last 10 years fundamentally changing and improving our credit risk management framework. Today, we have a robust and dynamic process, sitting on appropriate concentration risk, sound underwriting, rigorous client servicing and early identification of potential problems.

We've also intensified our focus on risk adjusted returns and appropriate capital allocation, balance sheet optimization, derisking, and repositioning. Just as important we launched our continuous improvement initiative called, Simplify and Grow, focusing on our desire to make banking easier for our customers and associates, accelerating revenue growth and driving efficiency and effectiveness.

We've already benefited significantly from these efforts and we have much more to do. We have completed 16 of 67 initiatives, and expect to complete seven more by year-end. These efforts have allowed us to make significant investments in technology to better serve our customers and we're seeing the benefits of those investments.

For example, through our digital platform, year-to-date checking and credit card production have increased 24% and 91%, respectively. Loan applications have increased 55% and with mortgage in particular approximately 60% of all applications are completed online. Mobile deposits have increased 60%, now represent 13% of all deposits. These efforts are paying off and positively impacting the performance of our businesses.

Simplify and Grow has allowed us to make investments in talent, improve services and capabilities and in our markets, all while prudently managing our expense base, and these investments are also paying off. We continue to grow consumer checking accounts and households, as well as wealth assets under management. We're also succeeding in our priority growth markets, Atlanta, Houston, Orlando and St. Louis. Consumer deposits and checking accounts in these markets are growing more than two times faster than the consumer bank average.

Similarly, Corporate Bank revenue and loans are growing faster than the Corporate Bank average. Although, it's relatively early, we are very pleased with the performance of these markets as we are delivering results above our expectations.

With respect to the economy, our customers are still generally optimistic about their businesses. But they are becoming more cautious, given continued market volatility and uncertainty regarding trade and tariffs. Many are taking a wait and see approach when it comes to business investments. However, pipelines remain steady, good, but not great.

So in summary, we have a lot of positive momentum and feel good about how we're positioned. Our plan is to remain focused on the things we can control; meeting the needs of our customers with best-in-class service, while leveraging technology and making it easier for our customers to bank with us. We're also focused on the fundamentals of our business; generating positive operating leverage through disciplined expense management, while making prudent investment decisions. We're focused on soundness, profitability and growth and that order of priority. We believe our efforts will keep the company positioned to deliver consistent, sustainable results through every economic cycle.

Thank you for your time and attention this morning. I will now turn the call over to David.

David Turner

Thank you, John. Let's start with the balance sheet. Adjusted average total loans decreased approximately 1%. Adjusted average consumer loans increased modestly, led by residential mortgage and indirect other consumer lending. Adjusted average business loans decreased 1% and were impacted by our continued focus on client selectivity and overall relationship profitability. Average business loans also reflected

Average business loans also reflected lower line utilization and elevated paydown activity during the quarter, including increased capital markets activities.

We continue to focus on risk-adjusted returns and are not interested in pursuing nominal loan growth for short-term benefit. And as John noted, due in part to our hedging program, we are not pressured to stretch for growth. With that said, we continue to expect full-year adjusted average loan growth in the low to mid single-digits.

Turning to average deposits. Despite interest rate decreases on deposits and seasonal declines in public fund accounts, average deposits decreased less than 1% during the quarter, exhibiting the strength of our deposit franchise. So let's look at how this impacted net interest income and margin. Despite lower rates, net interest income was down just slightly compared to the second quarter and net interest margin declined only 1 basis point to 3.44%. Net interest margin and net interest income were negatively impacted by lower market interest rates and lower average loan balances, partially offset by declining deposit costs and the benefits of repositioning strategies in the investment portfolio that were executed in the second quarter.

Net interest income also benefited from one additional day in the quarter, which negatively impacted net interest margin. As expected, total deposit cost declined 4 basis points compared to the second quarter to 49 basis points and interest-bearing deposit cost declined 5 basis points to 77 basis points, one of the lowest in the industry.

The deposit beta associated with declining interest rates was 25% this quarter, and we expect to experience a deposit beta in the 25% to 30% range in the fourth quarter. In an effort to reduce net interest income sensitivity to long-term rates, we repositioned out of approximately $1.2 billion of mortgage-backed securities into prepayment protected securities this quarter. These reallocations reduced our exposure to mortgage-backed securities by approximately 7% and our related book premium by approximately 8%. We're also exploring additional opportunities to further reduce sensitivity to long-term rates. In fact, we added additional hedges subsequent to quarter-end that are intended to reduce the impact of lower long-term rates on 2020 loan originations.

Assuming two 25 basis point reductions in the Fed funds rate by year-end, we expect some near-term pressure on net interest income and net interest margin in the fourth quarter, which we can partially mitigate through reductions in deposit costs. Net interest margin is expected to move in the high 330s in the fourth quarter. However, we expect the first quarter margin to expand into the low 340s, as the benefits of our hedging strategy began.

Now let's take a look at fee revenue and expenses. We delivered strong results this quarter with adjusted non-interest income increasing 9% compared to the second quarter, led by growth in service charges, wealth management and mortgage, as well as favorable market value adjustments on employee benefit assets. The increase in wealth management income includes a modest benefit from the recent acquisition of an institutional investment firm, Highland Associates.

Total mortgage income increased significantly, driven primarily by increasing hedging and valuation adjustments on residential mortgage servicing rights. Additionally, mortgage production and sales income also increased, consistent with elevated production, highlighting the benefit of our strategic focus and our decision to add mortgage loan originators earlier in the year. Partially offsetting these increases were declines in capital markets income and card and ATM fees.

The declining capital markets income was attributable primarily to decreases in M&A advisory services and loan syndication revenue. Customer swap income was also negatively impacted by CVA adjustments during the quarter. Looking ahead, we expect capital markets to finish this year on a strong note with fourth quarter revenue exceeding this quarter's reported results. The decline in card and ATM fees reflected the impact of favorable commercial interchange rebate adjustments recorded in the prior quarter that did not repeat. We continue to expect full year adjusted revenue growth of approximately 2%.

Let's move on to non-interest expense. Adjusted non-interest expense increased less than 1% compared to the prior quarter, driven primarily by higher salaries and benefits, partially offset by decreases in professional fees and outside services. The increase in salaries and benefits was driven primarily by an increase in the market value on employee benefit assets, as well as higher production-based incentives, one additional weekday in the quarter and the addition of Highland Associates. These increases were partially offset by continued overall staffing reductions.

The decreases in professional fees and outside services were primarily due to lower legal costs, and our continued success in reducing overall third-party spends. The company's third quarter adjusted efficiency ratio decreased 90 basis points to 57.4%, and the effective tax rate was approximately 20.6%.

As John mentioned, we continue to benefit from our continuous improvement process, and several Simplify and Grow initiatives are exceeding our initial expectations. For example, at Investor Day, we committed to reducing our total square footage by 2.1 million square feet and our third-party spend by $60 million to $65 million by 2021.

We also told you we plan to consolidate 100 branches during the same period. We are proud to say that we are on track to exceed our targets in each of these areas, and we'll continue to look for opportunities to pull forward or expand on initiatives where we can. These efforts exhibit our commitment to achieving positive operating leverage. Based on our results through the first nine months and our expectations for the fourth quarter, we expect full year 2019 adjusted expenses to be relatively stable with 2018. With respect to our effective tax rate, we tightened full year 2019 range to 20% to 21%.

So let's shift to asset quality. Overall, credit results remained in line with our risk expectations during the quarter. We saw improvement in several categories, while experiencing some normalization in others. Net charge-offs were unchanged at 44 basis points, in line with our expected range of 40 basis points to 50 basis points for 2019. The allowance for loan losses amounted to 1.05% of total loans, and 188% of total non-accrual loans.

Non-performing loans decreased 13%, while delinquencies and total troubled debt restructured loans decreased 4% and 7%, respectively. Business services criticized loans increased 9%, driven primarily by increases in classified loans, partially offset by reductions in non-accrual and special mention loans. The largest increases to classified loans were attributable to energy, retail trade and manufacturing sectors.

As a reminder, our third quarter credit metrics also include the results of most recently completed Shared National Credit exam. Provision exceeded net charge-offs during the quarter, primarily due to these downgrades as we've begun to see some stress within the energy and tariff-related sectors. However, potential losses associated with these credits are expected to be modest and within our expectations. Moreover, we anticipate several will cure in full over the next few quarters.

Let me comment briefly on the CECL. In our second quarter 10-Q, we disclosed an expected increase in our allowance for credit losses of approximately $400 million to $600 million due to the implementation of CECL. As we get closer to adoption, we expect subsequent disclosures to include a tighter range of impact and will reflect evolving macroeconomic conditions and forecast, as well as any appropriate updates to loan composition and quality.

So let's take a look at capital and liquidity. During the quarter, the company repurchased 39.7 million shares of common stock for $589 million and declared $150 million in dividends. Our common equity Tier 1 ratio is estimated at 9.6%, in line with our target level of 9.5%. And we anticipate managing at this approximate level going forward. The loan deposit ratio at the end of the third quarter was 88%. And as of quarter end, we remain fully compliant with the liquidity coverage ratio rule.

Wrapping things up, in light of the challenging and changing economic backdrop, we are pleased with our third quarter financial results. We have a solid strategic plan, designed to deliver consistent and sustainable performance throughout any economic cycle.

With that, we're happy to take your questions. But do ask that each caller ask only one question to allow for more callers. We will open the line for your questions.

Question-and-Answer Session

Operator

Thank you. The floor is now open for questions [Operator Instructions]. Your first question comes from Ryan Nash of Goldman Sachs.

Ryan Nash

So I wanted to ask a handful of questions. Maybe just first on deposit costs. So we saw them come down nicely on the high-end of peers 25% to 30% decline next quarter. I just wanted to double check to make sure that's based on September and the potential for an October. And I guess, you know, you're one of the only banks we saw a top quartile performance on the way up. And now you're outperforming on the way down. So could you maybe just talk about what you're seeing about across both consumer and commercial and if Fed is to cut in October beyond a couple of times next year, is there further room to bring down deposit costs?

David Turner

Yes, Ryan, this is David. So we've talked an awful lot about how to manage net interest income and margin in changing rate environments and deposit costs being a key input is important to manage both. So let me start with consumer. We've done a really good job of adjusting our deposit cost while staying competitive in the markets we are competing in. And that's been a big driver of our deposit cost declining.

I think what you'll see going forward is probably more contribution coming from the commercial side they've done a pretty good job. A lot of those deposits are indexed, if you recall in the first quarter, we increased deposit cost because we had above average loan growth that we had to use deposits to fund that loan growth that's clearly subsided and we're looking at adjusting those deposit cost on the way down. So we have a beta of 25% to 30% that we are giving you guidance for and we think that will apply to the two rate -- potential rate cuts that we see for the remainder of the year.

Ryan Nash

And then if I could follow-up on expenses. I mean clearly the revenue environment has been challenging, you guys are doing a better job than others to defend the margin. David, you talked about completing 16 of 67 initiatives for Simplify and Grow and you're going have a handful more done before the end of the year, and you talked about upside some of the areas that the three big areas that you're saving on cost. So as you think ahead, you're clearly holding cost stable this year, but are there enough levers for you to continue to invest in things like technology and grow the business and continue to hold expenses flat beyond 2019? Thanks.

David Turner

So I won't comment quite on '20, yet. But the way we think about it is, we are continuing to make investments in talent, mortgage loan originators, commercial ORMs, wealth advisors. We've continued to make investments in technology, 42% of our $625 million is spent on new things that we need to have to continue to make banking easier for our customers. We have to do that and we will continue to do that. But in order to make room for that and control costs, we have to get better at literally everything we do.

So John has asked all of us, all 20,000 people that work here, how do we get better at whatever we do tomorrow than we did yesterday, so that we can continue to make room for investments that we want to make. We have inflation in our expense base of about 2.5%. So we have to overcome that inflation plus the investments to be able to hold our cost relatively stable like we've done for the last couple of years.

We will continue to seek to hold our cost down and we have a goal of efficiency to get to the 55% range, we mentioned that at Investor Day. We were 57.4% today, obviously it's very challenging in a low rate environment, but we are not giving up. We're going to continue to seek becoming more efficient as we go forward. So there is still room to control -- control cost into 2020.

Operator

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

Matt O'Connor

I was wondering if you could just talk about kind of big picture, how you think about balancing, protecting the profitability ratios versus growing the balance sheet, you've been keeping deposits relatively stable, it's helping NIM, you're obviously seeing good growth in service charges. So there's some puts and takes. But talk about the trade-off between the focus to protect the profitability. But then also thinking about trying to grow the balance sheet?

John Turner

Yes, I think it is a great question. It is very much a balance. We are focused on building a business that's going to be consistently performing, that's going to be resilient, it's going to be sustainable. And that means we've got to build a balance sheet that it is resilient through every economic cycle. We've clearly traded-off some growth for quality and we'll continue to do that, Matt.

As we focus on, we think it's a period of time in the economic cycle, and we need to be thoughtful, careful, client selectivity is really important to us. Early identification of problems, exiting relationships that may become problematic, really important to our future. So we talk often about the importance of soundness first then profitability and growth last, we are not going to grow just to grow. We don't need nominal growth.

We think the balance sheet is positioned to deliver consistent and sustainable performance and the profitability that we believe will adequately reward our shareholders and that will continue to be our focus.

David Turner

I'll add, Matt. We do expect to grow, as we said we would grow low to mid single-digits in terms of loans for the year. We were up about 4.8% year-to-date on an adjusted basis. And so what we're saying is, we do expect to grow. We're just not going to force growth on the balance sheet to generate nominal revenue and nominal income if the return gets harmed.

Matt O'Connor

And I guess just following up, I mean, you obviously had really nice loan growth in the first half of the year, a little bit of run-off this quarter and I think one of your other portfolios might start to run-off by end of the year. It's as you kind of put all it together in the comments that you made, what's kind of a more medium term outlook in terms of -- grow loans. And then also just comment on deposits as well. Thank you.

John Turner

Well, with respect to loan growth, I think what we've said is that we anticipate growing low single-digits typically with the economy, plus a little in the markets that we operate in. We think that that's appropriate if you look at year-over-year business services loan growth has been about 7.5%. We do have some run-off portfolios in consumer in particular.

We've seen some declines in equity lending and indirect auto. We're capping our exposure to indirect unsecured lending, but we believe that our focus on continuing to build out the consumer business. At the same time, our commitment to business services lending particularly middle market commercial lending will drive an appropriate amount of loan growth and allow us to continue to grow the assets on the balance sheet.

And with respect to deposits, we're focused on core relationships. And when you look at our consumer business, we believe that 93% plus of our customers maintain their primary operating account with us. We're continuing to grow consumer checking accounts at a rate we think faster than most of our peers, consumer demand deposits and consumer low-cost deposits growing over time. Similarly, with a focus on small to medium-sized businesses, winning their operating business, we think we can still continue to grow low-cost deposits, which is really the core of our business and the strength of our franchise.

Operator

Your next question comes from Ken Usdin of Jefferies.

Ken Usdin

David, could you talk a little bit about the balance sheet protection, a little bit more. Just reading in the deck, you added a little bit more on the hedging side to impact of lower long-term rates. So you said the program is largely completed, I guess, can you just help us understand the math of the magnitude of the step-up that helps get the NIM up as you look from fourth to first and then how that will cascade on its own throughout the year. Thanks.

David Turner

Yes. So I'll start Ken with the end in mind. We talked about the -- going into next year, we think our margin could increase into the low to mid-3.40 range. We have a chart with regards to our sensitivity our short-term sensitivity is taken close to zero. By the beginning of the year through all the hedges that kick in and starting, little bit in the fourth quarter, but primarily the first part of the year. What we want to do is we have more exposure on the long-end than a lot of our peers. So we wanted to kind of neutralize that a bit.

So we've entered into a couple of million dollar worth of hedges that would really be -- that kind of got tied in when the tenure was in the mid-low 170 range to help us from the long-end. And that's really manifests itself and reinvestment of cash flows that come off the business every month. So that's baked into the guidance that we're giving you. And we believe that we're not going to have a disproportionate correlation to the tenure relative to our peers after this.

Ken Usdin

And on the left side of the balance sheet, can you just discuss the MBS repositioning that you did and what premium was and how does this change that magnitude that you'd expect. Thanks, David.

David Turner

Yes. So premium amortization was relatively stable in the quarter about $28 million in the quarter. What we did is we took some low-yielding investment securities that we could sell, we took those, we repositioned those into longer, a little more duration, a little more carry to help us. Just again boost a little bit from an NII standpoint, but they were really lower yielding mortgage-backed securities that we sold and reinvested.

Operator

Your next question comes from Betsy Graseck of Morgan Stanley.

Betsy Graseck

So couple of questions. You know the background for the question just has to do with the longer-term outlook for ROTC which I know you put out at. I think it was like 15% to 18%, is that right at the Investor Day?

John Turner

Actually, 18% to 20%.

Betsy Graseck

Sorry 18% to 20%, yeah, 18% to 20%, sorry.

John Turner

Little different interest rate environment.

Betsy Graseck

So the question that I have is, how are you thinking about that, you know, when I'm looking at it, I'm hearing. Okay. You've got a lot more opportunity on the expense side and maybe that expense -- operating leverage improves as we go through the next couple of years. But then I'm also wondering about the capital side of the equation here and how you're thinking about that. I know you have your 9.5% target, but given the tailoring rule that came out and everything else that's been happening for banks in your sizes, 9.5% still the right number for you?

David Turner

Yes. So I'll start with your last question. We calculate the amount of capital we need to have based on our models. Not, it's not regulatory driven, and yes, we are encouraged by the tailoring relief that we have, but does not change one iota the amount of rigor that we put in the capital planning and management. We still have, every other year our CCAR submission. So for the time being, 9.5% was our target. We try to put that in our prepared comments to even though our math really says, we could get to 9%.

We've added 50 basis points of cushion to enable us to take advantage of opportunities should they arise. As the market uncertainty and the economic conditions continue to decline a bit. As it relates, and the 9.5% was going to allow us to get to the kind of returns we think are appropriate given the circumstances that we're under.

Now the 18% to 20% was, as John was saying in the middle of your question that we had, and that was very different interest rate environment, we all thought rates were going to go up this year and they're clearly are down and they are forecasted to be down through the period of time we have covered by that Investor Day. So getting to 18% to 20% would be very difficult to do without taking some unusual risk, which we will not do.

So we're going to come out and we'll update the exact targets for you later, but clearly, there has been some decline in terms of return expectations. I think that's what's our -- the stock prices in our industry have reflected. But exactly, where those will be, we need to get a little better handle where we think rates will go. We have two baked in for this year, there's probably another one coming in '20 as well. So more to come, Betsy.

Operator

Your next question comes from John Pancari of Evercore ISI.

John Pancari

I wondered if you could talk a little bit more on the investments you're making in IT. I believe, you're currently evaluating, replacing your core deposit system and -- so I wonder if you can give us some details around that in terms of what's the timeframe around that type of project, what's the cost impact that we should be considering here, could it impact next year's numbers. And then, and then is there other systems -- are you looking at the core system on the loan side as well as or just the deposit system issue. Thank you.

John Turner

We just had our strategic planning offsite meeting with our Board, spend a lot of time talking about the topic and so I ask John Owen to address it.

John Owen

Yes, just to go back to Investor Day, we spend about $625 million a year on technology, have about 1600 plus technology professionals at the bank and every year in our strategic annual planning process, we go through about a three year to five year view and find out and we'll talk about what systems need to be upgraded, consolidated or replaced. And each year, there's about 15 systems that we identify that will need to go out and either upgrade or replace. So this is just a normal case of business from a cause of business today.

You mentioned some of the core systems around deposits. We are going to have an RFP that will go out in the first quarter for our deposit system. We will get those results back probably mid-year and we'll make a choice on what's the right platform for us. The timeframe for that, it's probably a three year to six year journey for this. What you'll find with us, when we do upgrades. We don't do very many big bang upgrades. This will be an incremental approach over a multi-year time period. So again this is a probably a four year to six year system exchange in this particular case.

But I would tell you, we do about 15 of these a year, this would be a larger one, of course, but again, to go back to our wealth platform, we did SCI a couple of years ago. We consolidated 14 systems into one. We're fortunate to operate on one consumer platform and we're in the point of implementing and seeing now at this point in time. So what I would tell you, it is large. We are in the RFP process, but this is nothing that we don't do 15 to 17 of every year.

John Turner

In our analysis John, we indicate that we can complete the work within the context of our current technology spend. So we don't see any outsized sort of allocation to expense associated with any of the core system changes.

John Pancari

And then one, I apologize, this is little bit off the radar a little bit, this question. But on Friday, you issued in 8-K that you're -- you announced that you're expanding your change of control provisions to -- an additional component of the management team beyond the

C-suite executives. Can you give us just a little bit of color, what that relates to and how common is it that you're modifying your change of control.

David Turner

Yes, thank you for the question. I guess, we really did two things to -- both were intended to standardize, you can imagine with the truest announcement, there's a lot of concern about what our future is what our intentions are, a lot of questions about what may happen going forward. It caused us to look at our change of control agreements and because the bank was the combination of a lot of banks over a long period of time, what we quickly concluded was we had a fair amount of inconsistency in our agreements both with respect to change of control and severance.

And so we asked our Board to consider a change in the or modifications to both change of control and severance, to make them more consistent, so they apply to both an appropriate group and they applied similarly to that group. And so it simply was the housecleaning sort of initiative for us to get everything in order. No real, significant change for our shareholders or frankly for our associates. But it does create some consistency.

Operator

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

Erika Najarian

Given your outlook for continued low to mid-single-digit loan growth and clearly, you laid out a very specific path for net interest margin. Is it too optimistic to think that net interest income could be flat next year?

David Turner

Well, we don't want to give guidance yet on what next year is. We have -- still have things that we don't know about, what will the rate environment look like. Clearly, that puts pressure on growing net interest income, we do think that, we've talked a lot about being able to grow the balance sheet consistent with with GDP and then some, then a little. Now, we've also done a lot of capital recycling to make sure that we're getting good relationship business on the books. And so you've seen some pressure on absolute loan growth there. But we expect to grow, and our teams have that expectation. So we have that piece of it, we feel good about. Let's just see what the rate profit gives us going into next year. Lower rates obviously put some pressure on us.

Erika Najarian

And as I think about your earlier response is clearly the ROTC range is potentially out of reach with given the interest rate outlook, but you did say you're not giving up on 55%. And as we think about the context of revenue challenges and potentially on that because of REITs and fees potentially peaking this year. I guess is there room for expenses on an absolute basis to actually be down if you get to continued efficiency improvement?

David Turner

Well, so our commitment has been and continues to be generating positive operating leverage in any environment. So we are seeking to grow revenue faster than the expenses. So where revenue continues to be challenge, we will continue to work even harder on expense management, feel that we can do that. So I think that clearly revenue is going to be challenged, kind of back to the last part, the last question is revenue will be challenged because 65% of our revenue comes from spread, and we had higher rates in the first half of the year versus the back half. And so on a comp '19 to '20, it would be very hard to grow revenue in that at least NII. So loan growth, will help us there a bit.

We'll see what the rate environment is, but we have good NIR, we have good investments that we've made, we expect that to continue to grow and as we just talked through our continuous improvement program to help and control expenses, we believe will generate positive operating leverage and continue to work our efficiency ratio down at the same time.

Erika Najarian

And I just want to be clear, even in an environment that you mentioned where it's very hard to grow revenue, Regions is still committed to deliver positive operating leverage.

David Turner

That's correct.

Operator

Your next question comes from Saul Martinez of UBS.

Saul Martinez

Couple of questions. First, more of a clarification, with the 25% to 30% deposit beta in the fourth quarter. Is that what's the denominator on that, is that on two cuts and hence it's a 12 basis point to 15 basis point reduction in deposit cost, it's not. I am just trying to make sure it's not on an average, the average fed funds rate because obviously you had July and September cut that's fully in the fourth quarter. I just want to make sure I understand the numerator and the denominator there.

David Turner

So it's based on two rate cuts that are baked in in October and December right now.

Saul Martinez

So it would be at the 12 basis point to 15 basis point reduction.

David Turner

Round numbers, that's right.

Saul Martinez

I guess more important question on loan growth, I hear what you're saying that under over the long run -- under normal conditions, you can grow your balance sheet in line with C&I -- and hopefully then some. But if I look at your loan growth this quarter period end it up I think 1% year-on-year.

Going forward, do you have indirect vehicles rolling off to maybe a few hundred a quarter, you have GreenSky as a headwind. Home equity is still a little bit of a headwind, your CRE book isn't really growing. It's contracting. I think on mortgage owner occupied, how, I mean, I'm struggling with how you get loan growth and interest earning asset growth next year. Can you just help me understand where you see the offsets, where -- I know you're not giving guidance for 2020. But how do I think about it conceptually, given you have pretty material headwinds from in multiple loan lines.

David Turner

So yes, there is a lot of stories inside the loan book. Let's kind of start at the top. So our big driver of loan growth has traditionally been our C&I book. Those can be lumpy from time to time. It depends on access to capital markets. It depends on line utilization, and you've seen some of that happen in this year. I mean it's, we had a lot of growth in the first quarter and no growth in the second, in the third quarter. We feel good about our pipelines, we feel good about our conversations. We're having with our -- with our clients, they are cautious, there're optimistic but they're watching this uncertainty with regards to trade and tariffs clearly put some pressure and downward sentiment in terms of wanting to make the next dollar fixed capital investment.

But that being said, we still think there is going to be some growth there from an investor real estate standpoint we've probably have the second-lowest concentration of investor real estate of our peers, we have some opportunities there. We are being very careful and selective with clients. So from time to time, you'll see that move up and then pay-offs will move it back down, but I think investor real estate is an opportunity.

Resi-mortgage continues to be an opportunity. We had a little bit of growth this quarter, production was up. About a third of that was refinanced and two-thirds of it was purchased. And we keep about almost half of what we, what we produce. So I think that'll be a plus in our direct consumer, we think it's going to be a plus. We making investments in unsecured even though GreenSky is running off, we have other avenues. I think John mentioned, we're going to cap unsecured, but we continue to see opportunities for a little bit of growth there.

Now home equity has been on -- quite a bit of decline over time, and we think that that will slow down a bit. So I think that when you and you had mentioned indirect vehicles being down. Those are really the key drivers. Again, we're not looking for a lot of loan growth, but I think, we'll have solid loan growth that will be profitable for the Company.

Saul Martinez

Can you remind the GreenSky is roughly $2 billion. And can you remind -- I believe and how quickly does it. What's the average, the weighted average life of that?

David Turner

It's about $1.9 billion actually. It has little low right at two years in terms of duration. There will be pieces of this at linear for a while, but the bulk of that's two year.

David Turner

And Saul while it's -- begins to run off. We've modestly increased our commitment to so far to grow that portfolio and we are investing in our own unsecured lending capabilities and we believe that we can match the timing of the run-off and the increase and so far with unsecured lending capabilities, all of which should help us on the consumer side in addition to growing mortgage, yearly bank card and growing direct lending.

Operator

Your next question comes from Gerard Cassidy of RBC.

Gerard Cassidy

Can you guys share with us, we hear and you guys already touched on your technology spend. I think you had mentioned $625 million is what is expected to be expense this year. How can we as outsiders, we hear a lot of stories about the big banks taking market share from the smaller banks, how do you guys measure whether you're keeping -- I know the dollars you're spending, but how do you measure whether you're keeping up from a digital technological standpoint that you can remain competitive with the bigger banks. What are some of the metrics should we outsiders look to -- to determine whether you're keeping up with these bigger banks?

John Owen

Yes, just real quick on that, this is John Owen. Like I said earlier, we spend about $625 million, about 42% of that is based on new initiatives and new projects and looking forward into new things which digital would be a big part of that, about 48% is around how we maintain the bank, maintain systems and really, our infrastructure going forward. About 10% is on cyber risk.

The way we think about -- are we keeping up and keeping pace. We use a few external factors. Number one would be JD Powers -- JD Powers ranks all of the top 23 banks are on their list and they come out with a quarterly ranking and they rank everything from how we perform in the branch all the way through to our online banking and mobile banking. So that's a data point we use consistently. We are in the top quartile for branch and online, mobile moves between top quartile and second quartile. So again that's an area where we're trying to always keep that in the top quartile.

The other source should be Gallup. Gallup also gives us good insights from our customers on how we're performing in digital and areas where we need to advance. The other thing I would point to is just the rapid growth of our digital at the bank. Over the last three years, our digital logins to our online and mobile properties were up 90%. You heard John talk about earlier on digital sales. Our digital sales are up 90% year-over-year. In credit card, our digital sales and savings accounts were up 35% and checking accounts, about 24%. So we kind of look at it from a couple of factors, how do our external parties validate what we're doing and also our internal growth rates.

John Turner

Yes, I'll just add, Gerard. The other thing I look at it is, are we growing consumer checking accounts? Are we growing low cost deposits and who are our new customers? And roughly half of our new customers are under the age of 30. And so all of those things for me are indicators that we are in fact competing and having success, offering compelling technology to our customers.

Gerard Cassidy

And David, you talked a bit about the CECL increase, you mentioned, you guys put out the number in the second quarter Q. I think you said $400 million to $600 million, which if you compare that to your existing level of reserves over a 50% increase. Everybody can -- appears to be able to handle yourself included the day one impact that you just described, how can you frame out for us. If you can what the day two impacts are going to look like? Should we as outsiders assume that we're going to see loan loss provisions of similar increases to what the day one impact was for everybody, or how are you guys looking at that at this stage?

David Turner

I would not say that day two would be anything remotely close to day one. Day one just kind of level sets and we are -- we'll see what other peers are coming out and what their -- what their numbers are really is dependent on portfolios those with consumer or longer dated loans are going to have higher CECL charges than those that are business services oriented that have shorter-term duration of their loan books. Day two, you need to think about, you still have charge-offs that come through. You have to provide CECL reserves and provisioning on loan growth, those have a tendency to be somewhat higher than we have today. Under the incurred model and again, very dependent on what type of loans you're growing, so mix makes a big difference.

So if you're growing mortgages versus commercial real estate, mortgages are going to carry a higher provision than commercial real estate as odd as that sounds. And then the last key factor is what's the economic outlook, how is that changing from time to time and that's why we put in our prepared comments, we've given you $400 million to $600 million, but is really dependent on what it looks like December 31/January 1, what do we think the -- the forecast looks like going forward. That makes a big difference in day two, when that change occurs things getting better or worse, you see in particular when they get worse or forecasted to get worse.

You can see much bigger provisions than you do other than in current model and that's what the standard was supposed to do. It was trying to have your reserve much quicker. And that's why we've talked about pro-cyclicality of the standards is as pro-cyclical as you can get because in a down rate cycle, you're going to be reserving more for loan growth, which is -- which causes one to be concerned about the cost and availability of credit in a downturn.

Operator

Your next question comes from Brian Foran of Autonomous.

Brian Foran

I guess I had a couple of questions on your slide appendix. First of all, thank you for this level of detail on the commercial loan portfolio or some of the key areas you're highlighting. It is quite a lot. I guess, as I look through Slide 14 or really maybe Slide 15 through Slide 17 because the energy you've talked about before. The restaurant, the retail, the manufacturing, transportation. How are you positioning this? Is this just being responsive to investor questions or are these areas you're actively concerned. Are there any sub portfolios where you seen opportunity to maybe take some market share. I guess how should I interpret all this detail why you're highlighting restaurant, retail, manufacturing and transportation?

Barbara Godin

Brian, this is Barb Godin. On that note, we do have some concerns in the restaurant portfolio that we seeing some softening in the restaurant portfolio. There's certainly been some softening in the energy portfolio, a little bit manufacturing, but by and large, we decided to be much more transparent providing you with information on our portfolios, so that -- all of you have an opportunity to look and say, look, we see what's in their portfolio, we feel good about their portfolio, we feel good about our portfolios and our ability to manage it and we just felt that now was the time to be, as I said, much more transparent, particularly as we go into with potentially looks like a credit cycle that will happen in the next couple of years.

Brian Foran

And then maybe in a similar vein on Slide 12. I mean, I almost hate to ask this, but it's always a little bit of a lightning rod for investors. The leverage loan balances certainly recognizing the $6 billion is a much bigger number than the standard definition of which would produce $2.5 billion, you highlight in the slides. But I think when you first gave this is about $5.5 billion. So why is it kind of crept up a little bit over the past six months to nine months, is that you participating more or is that just some credits tripping into your leverage definition. Why is the number gotten a little bigger?

Barbara Godin

We do have a number of credits that again based on the way we define it, will become leverage even though they started off as not leveraged. Additionally, we've got Ronnie Smith here, who runs that portfolio and I'm going to ask him to make a couple of comments on it.

Ronald Smith

Yes, just a couple of comments. And one of your responses is exactly on target. We had a couple of really long-term relationships publicly traded companies that had positive credit events that pushed it over into our definition of leverage lending and if you combine those two, it was just over $400 million. We feel good about those particular companies and we'll see at least one of those resolved within a very short period of time. The other will resolve given a little bit more intermediate period of time, but there is not really a focus on growing that portfolio, other than continuing to support our existing relationships where we can build broad and deep relationships outside of the lending transaction online.

John Turner

I'd just add we actually manage it as a concentration risk like we do every other part of our portfolio.

Operator

Your next question comes from Christopher Marinac of Janney Montgomery Scott.

Christopher Marinac

I wanted to ask further on the credit explanation that you just gave, should we see a higher level of total criticized than we do now or will that number kind of vary. I know you had the spec change driving a lot of this quarterly shifts?

Barbara Godin

Yes, it's Barb again. In the criticized portfolio on particular classified, I think is what you're pointing to which drove that number up. So let me first start with saying, despite all that, our credit metrics for the quarter were within our broader risk expectation. We experienced improvement in several areas. As you know, delinquencies were down 4%, TDRs down 7%, NPLs down 13%, and charge-offs were flat. So we feel good there. And as well as you mentioned, David, did our Shared National Credits were included.

And just to comment on the Shared National Credits, we weren't agent on any of those credits by the way. If I speak specifically to our classified loan category, I'm going to categorize what happened this quarter as follows, which is really over half of the increase came from five energy credits that moved into the category, but since quarter-end, one of these credits has totally resolved and the other three credits are to a large energy services customer, that's staying with us for well over 50 years and they have the proven ability to perform through the cycle.

So for energy in general, I'll make the comment that our book right now was only 13% oilfield services and we also have gone through and have stressed our price deck on which we both lend as well as service our accounts down to $39.20. And that's against today's price, last I looked this morning. It was about $54 a barrel, give or take. So based on all of this and we've done a lot of work, we believe our energy losses will stay somewhere within a really manageable range of about $30 million to $50 million over the next year, in addition to energy -- next three year, sorry.

In addition to energy, we also had some asset-based loans that we move to classified this quarter with all of them currently being well within their asset values. So as such, we anticipate minimal to no loss on those credits. And lastly, we also review the top 80% of credits that moved to our classified category this quarter and again based on this, we're comfortable both our loss range of 40 basis points to 50 basis points for this year and 40 basis points to 65 basis points over the next year based on a slowing economy.

So I would summarize by saying, we don't see what happened this quarter as being a systemic issue, we are where we're coming off a period of historically low numbers and as such, we believe that some increase was to be expected.

David Turner

I will add, Barbara. The 40 basis points to 65 basis points loss rate was over the next three years.

Barbara Godin

Three years. I'm sorry.

Christopher Marinac

Okay, great, that's helpful background. And again with the inclusion of the additional categories, does that imply that restaurants and ABL and others had deterioration in the quarter or again, you're just giving more transparency to those in general?

Barbara Godin

There is some marginal deterioration, but we're really are just trying to get much more transparency.

Operator

Your final question comes from Stephen Scouten of Sandler O'Neill.

Stephen Scouten

I just had a follow-up question maybe to Betsy's earlier question around the ROTCE guidance and kind of this -- maybe more specifically why that would move down, I just remember from your Investor Day, you guys had a pretty not negative, but maybe a muted view on the economy kind of where, GDP was going to go. Fed funds were roaring to a zero range policy and even the tenure, I think around $150 million. So granted a lot of what we're seeing today is kind of what you guys predicted. So I'm wondering, what specifically is driving the change in expectations relative to what you said that?

David Turner

I think, Steven, our expectation of the tenure was closer to 3%, than the $150 million. At the time we gave that out. So there are two things that drive return is the numerator and denominator and that denominator impact on lower rates is pretty tough. When you have falling rate environment, clearly, the fair value of the investment portfolio and therefore book value increases and it's the same thing on all the derivatives that that we've added the fair value of those have obviously increased putting pressure on the denominator. So that's a -- that's more meaningful than you might think.

When you go through the calculation from a net income standpoint, clearly, we had rate expectations and margin guidance that had been as high as 370, down to a low of 340. That's where we are. And so 18% to 20% wouldn't predicated on being at the low end of the range. So I think, if you look at our industry and you think of just good core commercial banking, at 20% return on capital can get -- you can get there when you have a rising rate environment margins are continuing to expand. We don't have that. We have low rates, a relatively flat yield curve and no -- at least the market saying, no real expectations for rates to change over the next couple of years.

So it's really hammering out net income growth and return through making good investments to grow in IR, watching expenses, keeping tabs on credit quality. And that's what we're doing. But it's, it's, you can't get to those type of returns in this environment, if it persist.

John Turner

Okay, since we have no further questions. So thank you all for your interest today. Appreciate it very much. Have a good day.

Operator

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