

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

CMA.N - Q4 2023 Comerica Inc Earnings Call

EVENT DATE/TIME: JANUARY 19, 2024 / 1:00PM GMT

OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Curtis Chatman Farmer *Comerica Incorporated - Chairman, CEO & President*

James J. Herzog *Comerica Incorporated - CFO & Senior EVP*

Kelly Gage *Comerica Incorporated - Senior VP & Director of IR*

Melinda A. Chausse *Comerica Incorporated - Senior EVP & Chief Credit Officer*

Peter L. Sefzik *Comerica Incorporated - Senior EVP & Chief Banking Officer*

CONFERENCE CALL PARTICIPANTS

Broderick Dyer Preston *UBS Investment Bank, Research Division - Analyst*

Christopher Edward McGratty *Keefe, Bruyette, & Woods, Inc., Research Division - Head of United States Bank Research & MD*

John G. Pancari *Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst*

Jon Glenn Arfstrom *RBC Capital Markets, Research Division - MD of Financial Services Equity Research & Analyst*

Manan Gosalia *Morgan Stanley, Research Division - Equity Analyst*

Peter J. Winter *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Steven A. Alexopoulos *JPMorgan Chase & Co, Research Division - MD and Head of Mid-Cap & Small-Cap Banks*

PRESENTATION

Operator

Hello, and welcome to the Comerica Fourth Quarter 2023 Earnings Conference Call and webcast. (Operator Instructions) As a reminder, this conference is being recorded. It's now my pleasure to turn the call over to Kelly Gage, Director of Investor Relations. Please go ahead, Kelly.

Kelly Gage - Comerica Incorporated - Senior VP & Director of IR

Thanks, Kevin. Good morning, and welcome to Comerica's Fourth Quarter 2023 Earnings Conference Call. Participating on this call will be our President, Chairman and CEO, Curt Farmer; Chief Financial Officer, Jim Herzog; Chief Credit Officer, Melinda Chausse; and Chief Banking Officer, Peter Sefzik. During this presentation, we will be referring to slides, which will provide additional details. The presentation slides and our press release are available on the SEC's website as well as the Investor Relations section of our website, comerica.com.

This conference call contains forward-looking statements. And in that regard, you should be mindful of the risks and uncertainties that can cause actual results to vary materially from expectations. Forward-looking statements speak only as of the date of this presentation, and we undertake no obligation to update any forward-looking statements. Please refer to the safe harbor statement in today's earnings presentation on Slide 2, which is incorporated into this call as well as the SEC filings for factors that can cause actual results to differ.

Also, this conference call will reference non-GAAP measures. And in that regard, I direct you to the reconciliation of these measures in the earnings materials that are available on our website. With that, I'll turn the call to Curt.

Curtis Chatman Farmer - Comerica Incorporated - Chairman, CEO & President

Thank you, Kelly, and good morning, everyone. Thank you for joining our call. Although 2023 was challenging for our industry, we felt it was a year of achievement. Following industry disruptions, we protected relationships, stabilized deposits, maintained strong credit quality, enhanced our

capital and took steps to position our business for future success. In fact, we delivered record average loans and record net interest income. Despite the marketplace and instability, we advanced key strategic initiatives and received impressive recognition for our results.

Small businesses to highlight as we initiated a national expansion effort, delivered award-winning products and achieved our 3-year lending goal ahead of schedule. Noninterest income remained a priority as we launched targeted initiatives aimed at enhancing our products and increasing our mix of capital efficient income.

Although the economic environment remains uncertain, we observed a cautiously more optimistic trend in customer sentiment at year-end as we believe many expect less rate pressure in 2024. We remain committed to supporting our customers, and feel we are positioned to grow alongside them as the economy strengthens. Full year financial highlights are on Slide 4. With 7% growth, we produced our highest level of average annual loans despite the impact of deliberate authorization efforts in the second half of the year. Deposits remained a targeted focus, and we were pleased to see stabilization following the industry events and ongoing quantitative tightening. We delivered record net interest income, aided by higher rates and loan balances.

Credit quality remained strong, with net charge-offs well below historical averages. In all it was a strong quarter for the company, and we ended with a good fourth quarter. Since there are a number of notable items in this quarter's results, I'm going to hand the call to Jim to discuss those upfront and provide context for the remainder of the presentation. Jim?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Thanks, Curt, and good morning, everyone. Slide 5 details the notable items Curt referenced, most of which were furnished in an 8-K earlier this month. As previously announced, we recorded \$109 million in noninterest expenses related to the onetime special FDIC assessment. This was unchanged from indications provided in our December update.

Next was the accounting impact from the pending cessation of BSBY since approximately \$7 billion of our swap portfolio was designated to BSBY loans. The announcement impacted our ability to maintain hedge accounting for that portion of the portfolio and resulted in a net noncash loss of \$88 million. The key message is that cessation does not result in an economic impact, only a change in the time recognition of earnings. These recognized losses will accrete back and the normal course pay received cash settlements and earnings recognition on the swaps remain uninterrupted.

While the realization of losses flowed through to our regulatory capital ratios, they did not further impact tangible common equity or tangible book value. Also note, operationally, and from a customer perspective, we feel well prepared for a seamless transition. Third on the list were \$25 million in severance charges, which elevated fourth quarter noninterest expenses, and were intended to enhance future earnings power and create capacity for investment. We previously signaled such efforts were being considered, and we will discuss them in more detail later in the presentation.

The last item does not impact bottom line results, but created line item geography changes within our income statement. The finalization of our agreement with Ameriprise to serve as our new investment platform provider caused a decline in noninterest income, offsetting a decline in noninterest expenses. While relatively small impact in late 2023, we note it here because we expect a larger impact in 2024.

Slide 6 summarizes our fourth quarter results. Overall, the quarter performed in line with expectations, excluding notable items. Considering the impact of those items, I'm going to move to the individual line item slides to discuss quarterly results in more detail.

Turning to Slide 7. Our intentional balance sheet management reduced average loans and commitments in the fourth quarter. The exit of Mortgage Banker Finance contributed to almost half of the reduction in average balances. At year-end, approximately \$250 million in loans remained in that business. Muted customer demand due to elevated rates impacted general middle market balances, while increased selectivity, prioritizing full relationships and higher returns, reduced loans and equity fund services and corporate banking.

Ongoing funding of multifamily and industrial construction projects continue to drive higher commercial real estate utilization, but commitments declined for the second consecutive quarter as we strategically manage pipeline and originations. The floating rate nature of our commercial loan portfolio benefited from higher rates as loan yields continued to climb to 6.38% in the fourth quarter.

Slide 8 highlights the stability of our deposit base. Average deposit balances remained relatively flat to the third quarter at \$66 billion, even with declines of \$564 million in brokered time deposits and \$176 million related to the exit of Mortgage Banker Finance. Growth in general Middle Market and Corporate Banking reflects seasonal patterns while retail benefited modestly from promotional campaigns.

Declines in National Dealer Services deposits were attributed to operations, consistent with inventory and utilization trends observed in that business. Noninterest-bearing balances performed in line with expectations and the pace of decline continued to flatten. Ongoing success in growing interest-bearing deposits drove a 42% noninterest-bearing deposit mix, which we continue to view as a competitive advantage. Industry competition, the rate environment and successful promotional campaigns drove deposit costs higher to 312 basis points, resulting in a cumulative beta of 58% in the fourth quarter. Our deposit profile has historically been a strength and with our favorable mix, operating nature of our accounts and uninsured trends we feel it is even more compelling.

As shown on Slide 9, we continue to normalize our liquidity position, using excess cash to repay wholesale funding while retaining significant capacity. We absorbed \$1.2 billion in maturing FHLB advances and allowed over \$500 million in broker time deposits to mature in the quarter. We expect decisions on future wholesale funding maturities to follow the normal course monitoring of balance sheet dynamics and funding needs. At 78%, our loan-to-deposit ratio remained favorable and positions us to prioritize high-return loan growth going forward.

Period-end balances in our securities portfolio on Slide 10 increased approximately \$550 million as paydowns and maturities were more than offset by a \$975 million positive mark-to-market adjustment from rate movements late in the quarter. Treasury maturities and anticipated securities repayments are projected to benefit net interest income and AOCI, and we anticipate a 25% improvement in unrealized securities losses over the next 2 years.

Turning to Slide 11. Net interest income decreased \$17 million to \$584 million driven by higher rates and deposit mix as volume changes related to loans, deposits and wholesale funding were largely offset by lower balances at the Fed. Successful execution of our balance sheet optimization strategy has allowed us to reduce wholesale funding and enhance margin.

As shown on Slide 12, successful execution of our interest rate strategy and the composition of our balance sheet positions us favorably for a gradual 100 basis points or 50 basis points on average decline in interest rates. Of note, BSBY cessation did not impact the ongoing cash flow associated with our swaps listed on the slide. While we took a loss in the fourth quarter, we will accrete that loss back, with the majority coming back into net interest income in 2025 and 2026. We expect the impact in 2024 to be relatively muted, although there may be some mark-to-market volatility until we fully redesignate remaining impacted swaps to SOFR.

By strategically managing our swap and securities portfolio, while considering balance sheet dynamics, we intend to maintain our insulated position over time. Credit quality remains strong as highlighted on Slide 13. Modest net charge-offs of 15 basis points remained below our normal range, and the few we had were more concentrated in relatively higher risk portfolios.

We observed some normalization in general Middle Market and Corporate Banking, as rates pressured customer profitability. These normalization trends drove a slight increase in the allowance for credit losses to 1.40% of total loans. Nonperforming assets increased, but still remained historically low. Overall, our portfolio continues to perform as expected, and we believe migration will remain manageable.

On Slide 14, fourth quarter non-interest income of \$198 million included \$93 million in notable items. Excluding the impact of these items and an increase in deferred compensation, which is offset in expenses, noninterest income performed in line with guidance. While we continue to expect noncustomer income in 2024 to come down from elevated 2023 levels, we remain committed to investments to drive capital-efficient fee growth over time.

Expenses on Slide 15 included \$132 million in notable items. Beyond those items, increases in salaries and benefits reflected the impact of higher deferred compensation, offset within noninterest income. Increased consulting expenses are attributed to advancing strategic and risk management initiatives and a smaller gain on the sale of real estate in the fourth quarter had the net impact of increasing expenses.

Moving to Slide 16. We previously communicated an intention to address growing expense pressures and the structural impact to industry profitability from 2023 events. In addition to our normal efficiency efforts, this slide details incremental actions to recalibrate expenses in support of investments and enhanced earnings. Through this process, we are prioritizing customers and positioning the business for future success. Complementing efforts already underway to rationalize real estate, we initiated a plan to further reduce our physical footprint, including the closure of 26 banking centers where we assess nominal customer impact.

In order to enhance colleague efficiency and keep decision-makers close to our customers, we are streamlining our management structure and eliminating select roles. When combined with the impact of banking center closures, these actions eliminated approximately 250 positions.

Further, we are optimizing our product offering to enhance capital efficiency and returns and select contracts are being reviewed for renegotiation. In total, these actions have the effect of reducing expected 2024 expenses by \$45 million, growing to an estimated benefit of \$55 million in 2025. These decisions are challenging, and we do not take them lightly, but we feel they are necessary to support the sustainable growth of our business.

Slide 17 highlights our solid capital position. Even with the impact of notable items, our estimated CET1 grew to 11.09%. Rate movement, coupled with continuous paydowns and maturities in our securities portfolio, reduced losses within AOCI and increased tangible common equity to 6.30%. Based on the December 31 forward curve, we expect our unrealized losses to reduce by 1/3 by the end of 2025. Although the proposed capital changes do not apply to us based on our asset size, we favor a conservative approach to capital management and plan to monitor ongoing AOCI volatility and regulations as they evolve.

Our outlook for 2024 is on Slide 18. We project full year average loans to decline 1% to 2%, impacted by optimization trends late in 2023. While we expect some impact of selectivity to continue into the first quarter, we anticipate 5% loan growth from December to December, with contributions from almost all businesses. Full year average deposits are expected to be down 1% to 2% from 2023, but we project relative stability point to point. Following a seasonal decline in the first quarter, we expect customer deposits to stabilize and rebound in the second half of the year.

Based on the 12/31 forward curve, we expect full year net interest income to decline 11% from 2023, driven largely by year-over-year deposit mix. We expect deposit seasonality and to a lesser extent, less income from BSBY redesignation, slightly higher deposit betas and lower loan balances to impact first quarter net interest income. From there, we expect a small uptick in the second quarter and more pronounced growth in the second half of the year.

As it relates to BSBY hedge accounting, interest rates and timing of re-designation could create volatility and but we expect to eliminate most or all of that potential volatility from transition of indexes by the end of the first quarter. Credit quality remained strong, and we expect continued migration to be manageable. We forecast full year net charge-offs to move into the lower half of our normal 20 to 40-basis-point range. We expect noninterest income to grow 6% on a reported basis which would be relatively flat year-to-year when adjusting for notable items. As we signaled last quarter, we expect FHLB dividends, price alignment income from hedges and BOLI to decline from elevated levels. Customer income is expected to increase modestly with growth in fiduciary and capital markets and deposit service charges, partially offset by pressures in card, commercial lending fees, and the assumption that favorable mark-to-market derivative adjustments do not repeat.

Full year noninterest expenses are expected to decline 4% on a reported basis, but grow 3% after adjusting for notable items. Through successful execution of our expense recalibration efforts, we believe we have created capacity to prioritize investments designed to further enhance our funding base, revenue mix and capital efficiency as well as risk management framework. Even with 5% projected point-to-point loan growth, we expect to maintain capital well in excess of our 10% target.

We will continue to monitor AOCI volatility in the evolving regulatory environment as we evaluate the right time to resume share repurchases. In all, we are proud of our year, and we feel we've taken the right actions to support the future of our business. Now I'll turn the call back to Curt.

Curtis Chatman Farmer - Comerica Incorporated - Chairman, CEO & President

Thank you, Jim. Despite the industry volatility in 2023, we think it is important to take a step back and reinforce that our core business remained unchanged as shown on Slide 19. As a leading bank for business with strong wealth management and retail capabilities, our tenured colleagues

deliver value-added expertise to our impressive customer base. Our highly regarded approach to credit continued to perform well and has historically outperformed our peers. Tailored products are designed to meet the needs of our customers, enhancing revenue and retention. Our deposit profile has long been a strength, and investments in products and small business are expected to make this core funding source even more compelling.

Actions to recalibrate our expense base are designed to benefit our future, and at well over 10% strategic capital target, we believe we have a strong foundation. In August, we will celebrate our 175th anniversary. You do not achieve that kind of longevity without proving time and time again that you can successfully navigate disruptions.

In 2023, our model proved resilient. Our colleagues rallied to support our customers through an uncertain time, and we delivered record results. As we look forward into this milestone anniversary year for our company, I'm confident in our ability to deliver for our customers, colleagues and shareholders. We appreciate your time this morning, and we'd be happy to take some questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is coming from Peter Winter from D.A. Davidson.

Peter J. Winter - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

So there's been a lot of focus this earnings season on kind of a normalized margin range. I'm just wondering what you -- as some of these swaps mature, what the margin could get back to? Do you think it could get back to those pre-COVID levels in the 350 range?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

As you may know and recall, I don't like to get real specific on margin. I think this quarter is a great example of that, where we actually had a decrease in net interest income, but we had an increase in NIM. So a bank with our business model, where we have some lumpiness, you can get those correlations that don't match up. But I do see NIM trending in a very good direction. We ticked up this quarter. We will have a little bit of a tick down next quarter as the first quarter guidance would imply based on the percentage growth that we put in the outlook. But then we see a steady climb from there. I do see us by the end of 2024, actually getting above where this past fourth quarter was, and then we continue to project up from there throughout 2025 as we have swaps and securities roll off and we get into a more normalized environment.

So I do see a lot of momentum building for us in the second half of this year, and I see that momentum actually accelerating as we move through 2025. And of course, that's exclusive of the BSBY hedge accounting impact where we're actually going to have significant income added in 2025 on top of the factors that I just talked about.

Peter J. Winter - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

Got it. And then just a follow-up, you had really nice growth in the CET1 ratio. And even adjusted for AOCl, you're above the minimum 7% threshold. I'm just wondering, you mentioned in the prepared remarks looking at AOCl, but what are some of the parameters you're looking for to resume share buybacks? And then how much capital do you accrete on a quarterly basis?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes. Peter, number one, I do think we're on a very good track to comply with Basel III end-game rules should they end up applying to us. But with that said, we do have a little bit of flexibility based on the fact that we are in pretty good shape there. The #1 thing that I continue to keep an eye

on is the AOCI. It did come down significantly this quarter. But let's keep in mind, it came down after a number of quarters being more elevated. And then, since then, rates have ticked back up again. So I don't want to declare victory yet on the AOCI front for us or the whole industry. I mean it looks like things are going in the good direction, and we're certainly going to be in very solid shape to comply with any capital rules. But before we start to share repurchase up again, I would put AOCI at the top of the list that we want to keep our eye on to make sure that doesn't tick in the other direction again, a little more line of sight into what the overall economic environment is from an interest rate standpoint and just overall uncertainty standpoint.

But it does appear we are going to be in shape at some point to start the share repurchase, but we want to be cautious, and we will be cautious this year. Certainly, in the first half of the year, we won't be active in share repurchase. We'll keep our options open in the second half of the year. But I'll say that even there, we will likely be cautious unless we get a better line of sight in terms of interest rates and overall economic stability.

Peter J. Winter - D.A. Davidson & Co., Research Division - MD & Senior Research Analyst

And how much capital do you accrete roughly on a quarterly basis?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Well, it's going to depend on the quarter and the year and what's going on in the economy. I can tell you that, in 2024, we will likely not accrete a lot of capital, maybe a tad bit above where we ended the year. But with 5% point-to-point growth, even though we're going to have, I think, strong earnings next year. I don't think you're going to see us significantly above where we ended the fourth quarter. But I think as you move into 2025, you're going to start seeing some nice accretion from that point on.

Operator

Our next question today is coming from Manan Gosalia from Morgan Stanley.

Manan Gosalia - Morgan Stanley, Research Division - Equity Analyst

I wanted to ask on your loan-to-deposit ratio. It ticked down again in the quarter to about 78%. I get that you're looking for 5% loan growth point-to-point next year, and you might be bringing in deposits ahead of that. But I guess if the loan growth is contingent on rates coming down, why pay up for deposits now? Why not bring in the deposits later as the loan growth comes in? And what is the right loan-to-deposit ratio to consider as we look out into the end of 2024?

Curtis Chatman Farmer - Comerica Incorporated - Chairman, CEO & President

I might -- this is Curt. I might start and then ask Jim or Peter to add in. But on the deposit front, maybe just to keep the perspective here is that we consider deposits part of full relationships with clients. And we have clients for whom we have lending relationships and clients from them, we have deposit relationships and clients for and we have both. But in the case of growing deposits, we're going to grow deposits sort of in line of taking care of our customers. And having lived through what the whole industry lived through last spring, I don't believe this is an environment where we're going to look any deposits, turning the deposits away for lack of a better definition. We do believe that, that loan-to-deposit ratio will go up some, but we should be able to comfortably stay within our target, we believe, kind of in the mid-80s even with the point-to-point growth that we're expecting in 2024.

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes. Two points I would add on to that, Manan. I mean we love deposits and regardless of loans. I mean, we're making money on these deposits. We're not holding capital on them. we love deposits just for what they represent amongst themselves. But having said that, we certainly don't want to operate in a just-in-time funding capacity for loans. I mean we want to make sure we're prepared for when that loan comes. You can't necessarily turn deposits on, on a dime, but we welcome the deposits. We're not going to turn them away. We're making money on them, and they continue to add to the stability of the overall franchise.

Manan Gosalia - Morgan Stanley, Research Division - Equity Analyst

Great. And maybe a follow-up there on deposits. As rates start to go down, given your skew to commercial, how should we think about those deposit betas on the way down? If we do get fixed rate cuts or even more than that as we get into 2025, do you think the first few rate cuts are more beneficial given your skew to commercial? Or should you start to see more momentum in deposit costs coming down as you get into rate cut numbers 4, 5 and 6?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes, every cycle is different, so it's hard to say for sure. But I think, in this particular cycle, we could see a little bit of symmetry or what I might call a LIFO approach, last in, first out. I mean, certainly, we saw betas accelerate towards the end of the cycle, and even in the last couple of quarters without Fed hikes we've seen deposits continue to tick up. And so just as we've seen them more accelerated in the second half of the cycle, I think those might be the most sensitive deposits that we can take back down early in the following rate cycle.

So I am somewhat cautiously optimistic. We are assuming in the outlook about a 60% beta with not too big of a lag following the first rate cut. Having said that, every cycle is different. And I do recall back in 2019, the Fed cut 50 bps, I believe, in July '19. And I didn't see a lot of falling rates in the industry overall. That was a very controlled environment where the economy was still relatively strong. And I continue to think that the reason for the Fed cuts is really going to drive that beta. If it's a very orderly takedown of rates and the economy continues to be very strong, it may be a little stickier to bring them down. But if the Fed reduces rates because there is a little weakening in the economy, I think that gives banks a little more leverage. So I would just emphasize that every cycle is different, but we do think there is that potential for some significant beta in those first few cuts.

Manan Gosalia - Morgan Stanley, Research Division - Equity Analyst

Great. And do you have what percentage of your deposits are directly indexed to the Fed contract?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Most of our deposits are not. We're very much a relationship-based bank, and many of those were one-on-one conversations with customers. So we do have some reciprocal deposits that are -- you consider to be somewhat indexed. Obviously, the broker deposits, their time deposits are somewhat indexed, you can consider. But the vast majority of our deposits are not.

Operator

Our next question is coming from John Pancari for Evercore ISI.

John G. Pancari - Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst

First question, just around the loan growth expectation, the 5% point-to-point expectation, can you give us a little bit of color where do you see the loan growth drivers coming from? And when do you really see an acceleration there in overall loan growth as you look through 2024?

Peter L. Sefzik - Comerica Incorporated - Senior EVP & Chief Banking Officer

John, this is Peter. So it's actually pretty broad based. I mean, we mentioned this morning, we still have a little bit of mortgage banker finance at the end of December that will be working against us a little bit through the year. But then across the rest of our businesses, it's pretty broad-based. I do think -- I think dealer probably has sort of momentum going into 2024 that will continue throughout the year. Our EFS business, I think, is a business that, if you kind of look in the appendix, we've shown has dropped a couple of quarters. I think it will probably drop first quarter, but we think it will pick up quite a bit going into '24, but really broad-based across middle market.

We feel like we've got some really good momentum. I would tell you that we feel like customer sentiment changed a little bit in the fourth quarter in the right direction. And sort of our informal surveys that we do internally with everything seems to indicate that there's going to be some more demand as we get into what I would really say the second quarter, to answer your question, probably second and third quarter is where I think we'll start to see that pick up. I don't -- as we talk about today, our outlook on first quarter is pretty flat to down a little bit. But I think as we get into the middle of the year, we're getting indications that we'll start to see some real good loan growth that results in that 5% point to point.

John G. Pancari - Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst

Great. Okay. That's helpful. And then separately, your guidance implies, call it, ballpark about 900 basis points or so of core negative operating leverage based upon the midpoints of the guide. And I'm just wondering if the revenue picture ends up being more pressured than you currently forecast, do you have expense flexibility to improve that operating leverage? I know you set out the \$45 million in expense reduction from the recalibration in 2024. Can that recalibration benefit, that \$45 million cannot go up if revenue is pressured to a greater degree?

Curtis Chatman Farmer - Comerica Incorporated - Chairman, CEO & President

John, as Jim said in his prepared remarks that \$45 million becomes \$55 million on a run rate basis in 2025. And this is an interesting period of time. The whole industry has gone through an inflection in 2023, and somewhat of a recalibration, to use your words. We've tried to be thoughtful in terms of balancing the things that we believe are driving revenue for us, and will drive revenue for us going forward. That includes some of the products that we've invested in, especially in treasury management, payments, capital markets, wealth management. It also includes the focus on small business, expansion into new markets into the Southeast and into the Mountain West, Colorado region. And so we want to stay focused on those because we're trying to really play the long game here and try to get beyond sort of the immediate environment that we're operating in. And then secondly, I would say, while we did have some expense initiatives in the quarter, we're always thinking about additional efficiency opportunities. And again, it's all about sort of balancing between those 2. And so my hope is that we would see positive operating leverage really based on overall revenue growth and a return to a more normalized interest rate environment and hopefully a soft landing on the economy and a lack of further credit deterioration, et cetera.

If we don't see that, then obviously, we need to think about what else we can do from an efficiency standpoint.

John G. Pancari - Evercore ISI Institutional Equities, Research Division - Senior MD & Senior Equity Research Analyst

Just regarding that, when do you expect you could break into more of a positive operating leverage trajectory?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes, John, it's Jim. I mean, number one, just to build on Curt's comments, I do think 2024 is a bit of a transition year, not just for us, but for the whole industry, I think you're hearing that from some of the other calls too. We're in this kind of tweener stage where interest rates and pay rates and deposits continue to edge up a little bit, yet the Fed isn't raising rates. So that makes it a really challenging year. I do think things will start to move in the positive operating leverage structure in 2025. We don't have a complete line of sight into that yet, but I mentioned how we expect net interest income to really have some great momentum as we enter into 2025. And of course, that's always the goal to have a positive operating leverage.

And on the topic of expenses, I'll just add that I think that really is a journey, not a destination. We always have to be looking at expenses. I don't think this will be the end of taking a really hard look at what we can do over time. And I think expense reduction is really having a purpose for twofold. One is to create capacity for investment which continues to be critically important, probably more so now than ever. And then secondly, to make sure we get that positive operating leverage. So we will continue to kind of keep an eye on not just normal budget hygiene, but actually seeing what more significant steps we can take over time. So as I said, a journey, not a destination. And I think '25 should have things moving in a better direction. But again, not a complete line of sight into that.

Operator

(Operator Instructions) Our next question is coming from Jon Arfstrom from RBC Capital Markets.

Jon Glenn Arfstrom - RBC Capital Markets, Research Division - MD of Financial Services Equity Research & Analyst

Question on your net interest income guide. What kind of rate assumptions do you have in that in any kind of rate scenario that you think derails that from what you're thinking today?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes, we did assume the 12/31 forward curve, which has almost 6 rate cuts in it. You'll notice on our asset sensitivity page that for the first time, that I can recall at least, we became liability sensitive. So I think this is a very fortuitous time for us to become liability sensitive with potentially 6 rate cuts out into the future. We do have the sensitivities there using a 60% beta. You can see that we do benefit from fall in rates, assuming that we can reprice as expected without too much of a lag. So I would say if we get fewer cuts than that, that will put a little pressure on that outlook. But we are benefiting from the 12/31 curve if we really do get those 6 cuts. So that's the assumption, and we'll continue to monitor, and we'll see where the economy and where the FOMC goes.

Jon Glenn Arfstrom - RBC Capital Markets, Research Division - MD of Financial Services Equity Research & Analyst

Okay. Yes, a lot going on this morning. I had to rub my eyes when I saw that slide. I guess my -- one of my follow-up questions and maybe you answered it is, do you still consider yourself asset sensitive? And I guess the answer is no at this point?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

That's what our models would say. You never know how customers are going to react, and the competition is going to react. But I would say we are a little more liability sensitive than we are asset sensitive. Now with that liability sensitive could have a little bit more of a lag in it than what we're projecting. We just don't know how customers and competition will react. But over the course of time, it does appear that we are a little more liability sensitive.

Jon Glenn Arfstrom - RBC Capital Markets, Research Division - MD of Financial Services Equity Research & Analyst

Okay. Point of clarification on the expense piece of it. Is it \$45 million in '24, and an incremental \$55 million in '25 or an incremental \$10 million in 2025?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Incremental \$10 million.

Jon Glenn Arfstrom - RBC Capital Markets, Research Division - MD of Financial Services Equity Research & Analyst

Okay. Okay. Good. And then, one, Melinda, I thought you'd get it pass, but I just -- I wanted to ask one credit question.

Melinda A. Chausse - Comerica Incorporated - Senior EVP & Chief Credit Officer

Sure.

Jon Glenn Arfstrom - RBC Capital Markets, Research Division - MD of Financial Services Equity Research & Analyst

On Slide 13, that bottom right, corner where you show the percent criticized in TLS, leverage, then auto. Curious how elevated is that relative to normal. I don't know if there is a normal, but how elevated is that? And what does it take for those to come back down?

Melinda A. Chausse - Comerica Incorporated - Senior EVP & Chief Credit Officer

Yes. Thanks for the question. I mean, not surprisingly, but a positive surprise this quarter was that we actually saw improvement in 3 of the 4 incremental monitoring portfolio. So we saw balances and criticized assets go down in TLS leverage and automotive production. I would say that, that leverage portfolio at 10% to 12% is about normal. That is an elevated higher risk portfolio by its very design. TLS, again, it's going to be elevated above the normal portfolio at 18%. I would say that's still above sort of historical norm. But we are seeing positive momentum in TLS. Certainly, the rate environment, if it cooperates with the curve, it is going to be a real positive for that segment as well as leverage.

You didn't ask about commercial real estate specifically, but we did see that one relatively flat in the fourth quarter. So we've got some assets that are moving into the criticized bucket, but we also have assets that are moving out of the criticized bucket, and they move out when they either pay off or we remargin them and get them back into a conforming state. So I feel really good about all of those portfolios that are listed there on the right and would expect that we should -- again, if the rate environment cooperates and we don't see a downturn in the economy that we'll continue to see these stable to potentially improving towards the back half of the year.

Operator

next question today is coming from Steven Alexopoulos from JPMorgan.

Steven A. Alexopoulos - JPMorgan Chase & Co, Research Division - MD and Head of Mid-Cap & Small-Cap Banks

So I want to start by going back to your answer to Peter's question, the first question on NIM. And it's funny. For all the years I've covered the company, I think you were the most asset sensitive. And if you look at the historical NIM range, it's literally all over the place. And Jim, what you've done now is you've basically restructured the balance sheet, so it's fairly neutral. Even if I look at this 100 basis point gradual and 60% beta, it's like 6 bps or so benefit to NIM. So assuming that we get here, let's say, the forward curve plays out, we go to 100 basis points or so of steepness. Does that imply your NIM, the new NIM for Comerica is like 3%, right (inaudible). I mean, a year ago, you were [374] I'm down a ton. And I'm trying to

figure out like what the hell does the margin look like at this company with this balance sheet in a normal rate environment that has actual steepness to the curve? And you are basically a 3% margin bank now because you've taken away the asset sensitivity?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

We have bounced around quite a bit over time, Steven, and we didn't necessarily think that was always a great thing. I do think stability is important. The rate environment is one factor. Again, just the overall construction on the balance sheet and the lumpiness in the amount of cash we're carrying or securities we're carrying is also a factor. And just again, our business model creates a little bit more lumpiness in that regard. So we would like a little bit more stability. As I mentioned in Peter's question, I do see our trajectory going north of where we ended here, and I think we'll continue to go north as we move through 2025. So we're above 3% on a normalized basis. And I think we are going to have a much more stable NIM and net interest income earnings capacity going forward. I don't necessarily want to give an exact number, but it is north of 3% for sure.

Steven A. Alexopoulos - JPMorgan Chase & Co, Research Division - MD and Head of Mid-Cap & Small-Cap Banks

Okay. Okay. That's helpful. But keep in mind, that's why generalist don't put their money in regional banks because the black box said the management team don't really help. Shed some light on what expectations are. I want to ask on expenses, too. So you guys are guiding to around 3% operating expense growth in 2024, and that's with the benefit of the new initiatives. Just a big picture view, why is expense growth at the company so much higher than other regionals? I'm sure you look at all the other regionals. It's higher.

And then if we think about 2025, if you don't announce another initiative, should we expect the growth rate to lift off of 3%?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Many of the expenses that we have in 2024, a lot of the investment we're making is not ongoing run rate. A lot of it is more onetime effort to get some of these initiatives up and running, whether they're on the revenue side, the product side or the risk management framework side. So I wouldn't necessarily assume that the expenses that we are incurring in '24 all carry over to 2025. But we are in an investment mode. I mean, I think we may be underinvested in certain years if you go back historically. So I do think there's a little bit of catch-up going on, but we are committed to make sure that we can compete in the years coming forward. And we do think a certain amount of investment is required there, and we feel comfortable it's going to pay off.

Steven A. Alexopoulos - JPMorgan Chase & Co, Research Division - MD and Head of Mid-Cap & Small-Cap Banks

Can you expand on that, Jim, like where did you underinvest and where are you catching up now?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Well, I would say, #1, some of it is just moving with the times with the digitization and some of the online capabilities. But I would also say that whether it be risk management framework or some of the product innovation, I just don't think we necessarily always invested as much as we could have historically. And rather than trailing on that front, we'd rather be leading. So we think the easier thing to do would be to hunker down and just start the company, and that's not something we want to do. So we feel like we're doing the right thing, and we do feel like it's going to pay off a positive operating leverage as we move forward.

Steven A. Alexopoulos - JPMorgan Chase & Co, Research Division - MD and Head of Mid-Cap & Small-Cap Banks

Got it.

Curtis Chatman Farmer - Comerica Incorporated - Chairman, CEO & President

This is Curt. I just would add that we -- as I said earlier, we are focused on top line revenue growth. We believe we have opportunities on both the fee income side and with the loan portfolio. But certainly, if we do not see growth materializing, if the economy does not move in the right direction, if interest rates don't move in the right direction, allowing us to get some relief on deposit betas, et cetera, then we'll continue to look at expense opportunities.

I'd also add that part of this, from a risk framework standpoint, is continued investment in preparation of potentially being over \$100 billion or if Basel III requirements step down to banks sub \$100 billion kind of in our category at \$86 billion.

Operator

Next question is coming from Chris McGratty from KBW.

Christopher Edward McGratty - Keefe, Bruyette, & Woods, Inc., Research Division - Head of United States Bank Research & MD

On The expenses, Jim, I think you've talked historically about roughly \$50 million for the \$100 billion rules as you kind of know them today. How much -- I guess how much can you remind us how much you've accrued or is in the guide for 2024 related to that?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

I would say we have a small portion of that in the guide for 2024. The vast majority of that \$50 billion is probably more likely to be in future years as we get closer to \$100 billion. But there are several million dollars in there as we really try to address those things a category for that we think have a longer runway to get ready for. So those items that we think would take, say, 2, 3, 4 years to really be ready, we're getting those things in motion now. There's a -- the majority of the category 4 requirements we either already have, or if we don't have them, we think we could complete them within 1 to 2 years. And so we're holding off on that.

So the majority of the \$50 million is still out there in the future, but we do have some of that in the run rate in '23 and a little bit more in '24.

Christopher Edward McGratty - Keefe, Bruyette, & Woods, Inc., Research Division - Head of United States Bank Research & MD

Okay. Great. And then maybe one for Curt. I think the Street's got you roughly a low teens return on tangible common equity in this year and next. Can you maybe elaborate on how you think of the return potential of this company? Obviously, you've got a much more stable margin over time, but you're also balancing some of the investments.

Curtis Chatman Farmer - Comerica Incorporated - Chairman, CEO & President

Yes. I wouldn't maybe give a forecast exactly around returns or even multiples on the company. But I would say that we believe that based on the comments we made earlier, certainly '23 was a disruptive year and a reset for the industry in '24, I think, is some recalibration. I believe that interest rates are going to come down. And when they do, I think it will have a positive impact on NII for us. And we believe, as we said earlier, that in the latter half or second half of the year that we will start seeing NII return. We think we've got great opportunities on the fee income side, and we showed that in 2023. And we think we've got good growth opportunities in terms of the loan portfolio. And so our goal is to get to positive operating leverage and believe that we can either return at a level that's commensurate with the industry overall or better from a longer-term perspective. But '24 will be somewhat of a continued inflection year.

Operator

Next question today is coming from Brody Preston from UBS.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Jim, I was hoping maybe you could help me nail down the cadence of the kind of BSBY swap amortization, the accretion in the NII. How much of that -- I think you said most of it's in '25 and then into '26 but How much of it happens in 2024? And then how much happens in '25 and '26?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

we don't have a 100% clear line of sight into that because out of those \$7 billion of BSBY hedges or hedges dedicated to BSBY loans, a little less than \$3 billion of them are not redesignated yet because we have not generated enough SOFR loans to redesignate those particular hedges. We do expect to have that complete or at least largely complete by the end of the first quarter. And I think at that point, we'll actually have a fair amount of certainty as to how it plays out. But in general, the way it looks right now in the forward curve and this is exclusive of what I offered in the guidance because, again, there's a lot of uncertainty there, there was likely a very -- somewhat mild negative impact in 2024. To the extent there is any kind of negative impact, you just accrete that back in later years. So again, it's not an economic loss.

And then we are very likely to get the vast majority of it back in 2025. Think of it as maybe north of 80% of that loss accreted back in 2025. And then most of the remaining after that would come in 2026.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Got it. That's helpful. I guess if I can just ask one fine point just on the first quarter with the redesignation. Should we see something similar to what we saw this quarter, maybe not in terms of size, but just directionally, where there's a negative kind of nonoperating impact to fee income and maybe a small positive impact to NII?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

It really depends on the rate curve that's going to drive it, maybe to a lesser extent, the timing of when we redesignate. Certainly, it's going to be a small fraction of what you saw in the fourth quarter. And again, whatever you do see, will simply accrete back in future quarters. So I don't think there's -- I know there won't be any kind of economic surprise there. But from an accounting and recognition standpoint, there will be a little volatility in the first quarter. And again, we'll accrete that back in later quarters and likely mostly in 2025. But a little bit of volatility in Q1, but also a large amount, if not complete certainty after Q1 also, and we can lay out that exact guidance and cadence.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Got it. So you don't have the dollar impact for the first quarter -- an estimate for the dollar impact to NII for the first quarter yet from this -- from the BSBY stuff?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

We don't. We need for the dust to settle in terms of just getting the rest of these redesignated and where the rate curves will drive that. And again, we'll be made whole ultimately over the next couple of years.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Got it. Okay. If I could ask just another one on the NII guide for the year. I think you said it was a 60% beta that you were running through the guidance. Do you happen to have what the noninterest-bearing deposit mix that's underlying the guidance is for next year?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes. We continue to think that we're going to bottom out in the low 40s or very near 40%. So we've been pretty consistent on that over the last 2 to 3 quarters. Of course, a big driver of that isn't so much even just noninterest-bearing deposits, but where interest-bearing goes. And we do plan on having great success with interest-bearing deposits as it relates to customers. On the other hand, at some point, we probably will pay down some of these broker deposits that we have because it's really a form of wholesale funding that all banks make some degree of use of. So the overall level of interest-bearing will, of course, play some optical games with that percentage, but our base case is to be in the low 40s towards nearing that 40% point.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Okay. And then I did just want to ask on the liability-sensitive disclosure. Could you maybe help me think about the moving parts that make you liability sensitive just because like if I just simply looked at you versus a lot of your peers with 40%, 41%, 42%, whatever it is right now, NIB and still effectively 60%, I think, floating rate loans, like both of those items -- 60% might be closer to what I would call regional bank on average for floating rate loans, but the 42% NIB is still above average. So I would holistically think about you as being mildly asset-sensitive, but what are the moving parts elsewhere on the balance sheet that push you towards liability sensitivity?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes, that's a good point, and we do stick out in a very good way with our high level of noninterest-bearing deposits in the mix. Where we also stand out and because we have that higher level of noninterest-bearing deposits, we did put more swaps and securities on the book to manage to a more interest-neutral position over the last year. And so that's exactly why we added those hedges. And that's what's offering us the protection in a down rate environment.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Okay. So it's mostly the hedges then, I guess, combined with securities balances?

James J. Herzog - Comerica Incorporated - CFO & Senior EVP

Yes. I mean it's the -- we always look at it holistically between both the hedges we put on in the form of both swaps and securities. But that's the balancing x factor to your equation there.

Broderick Dyer Preston - UBS Investment Bank, Research Division - Analyst

Got it. And then last one for me is just around the brokered deposits. I think the guidance assumes flat brokered deposits moving forward. I guess, would you look to use the securities maturities kind of exclusively to pay down borrowings? Or is there opportunity to kind of run off broker deposits next year, even though it's not contemplated in the guide?

James J. Herzog - *Comerica Incorporated - CFO & Senior EVP*

Yes. I would say the runoff of securities will be used for a combination of funding loan growth and reducing wholesale funding. And I think of wholesale funding is both being some of the debt borrowings like FHLB, any security maturities we might have or bond maturities we might have and broker deposit maturities. So -- but we still a mixture that goes on there in terms of the overall formula. But I suspect, over time, and it's actually a goal of ours, to reduce brokered deposits over time. So at some point, you will see a reduction there. And securities maturities will be one of the inputs to that equation.

Operator

We have reached the end of our question-and-answer session. I'd like to turn the floor back over to President, Chairman and Chief Executive Officer, Curt.

Curtis Chatman Farmer - *Comerica Incorporated - Chairman, CEO & President*

Let me again thank everyone for joining us today. As always, thank you for your interest in our company, in Comerica, and I hope you have a nice day.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2024, Refinitiv. All Rights Reserved.