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Regions Financial Corp. (RF)

Q2 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Paula, and I will be your operator for today's call. I would like to remind everyone that all participants' phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator Instructions]

I will now turn the call over to Mr. List Underwood, to begin.

M. List Underwood

Head-Investor Relations, Regions Financial Corp.

Thank you, operator, and good morning, everyone. We appreciate your participation on our call this morning. Our presenters today are Chief Executive Officer, Grayson Hall, and our Chief Financial Officer, David Turner. Other members of management are present as well and available to answer questions, as appropriate. Also, as part of our earnings call, we will be referencing a slide presentation that is available under the Investor Relations section of regions.com.

Finally, let me remind you that in this call and, potentially, in the Q&A that follows, we may make forward-looking statements which reflect our current views with respect to future events and financial performance. For further details, please reference our forward looking statement that is located in the appendix of the presentation. That said, I'll turn it over to Grayson.

O. B. Grayson Hall

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

Thank you, List, and good morning, everyone. We appreciate your interest in Regions and participation in our second quarter 2014 earnings conference call. Today, we reported earnings of $292 million, $0.21 per diluted share. Overall, we're pleased with our results, which reflect our steady progress, as we continue to effectively execute on our business plans. Total revenue was diversified among product lines and increased 2%. Meanwhile, our adjusted expenses declined, improving our adjusted efficiency ratio 270 basis points, to 64.2%. And, importantly, our number of customers and quality households increased again in the second quarter. We're continuing to build on our solid foundation by focusing on the fundamentals.

This quarter, we grew loans, deposits, and checking accounts. In addition this quarter, we were able to increase our shareholder dividends to $0.05 per quarter. Through the first half of 2014, loans increased $1.9 billion, or 2.6%. Business lending has delivered strong growth this year, which has become more broad-based geographically and by industry time. We are seeing momentum in our upper middle market sector, as companies are beginning to demand credit. But competition remains elevated in this lending segment.

On the consumer side, credit card and mortgage balances increased, and indirect auto portfolio continued to expand. Growth in indirect lending portfolio was driven, in part, by process improvement initiatives instituted earlier this year. These initiatives improved loan processing automation and increased pull-through rates on loan closings. As a result, sales production per dealer has increased 18% in the first half of 2014.

Across the organization, we are focused on driving process improvement to reduce variability, improve process and performance, and accelerate efficiencies and effectiveness. As with the indirect auto example, our efficiency

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initiatives extend beyond expense reductions and also focus on ways to enhance revenue. We currently have several initiatives underway to optimize loan processing, enhance the customer experience; develop small business online banking capabilities, and much more. We're also continually working to identify customer needs and provide customers with the type of products and services they want and need, while making it easier to do business with Regions. It is the personal dedication from every associate that is making the difference at Regions. This commitment is not only from our customer-facing associates, which are regularly recognized for their excellent customer service, but also for the back-office support associates here constantly working to improve our processes, our products and our technology.

While the economic environment continues to improve and recover, we are staying focused on the things we can control. This quarter's decline in interest rates makes top line revenue growth even more challenging. However, we are committed to our prudent credit standards in order to increase revenue. As a result, our asset quality continues to improve, as net charge-offs, non-performing loans, troubled debt restructurings declined in the second quarter.

In order to create a more streamlined corporate structure focused on execution, we recently realigned our business units and geography leadership, creating a general bank which consists of businesses that serve retail, wealth management, and business, and a small bank and a corporate bank which consists of businesses that serve middle market and large corporate clients. Importantly, we believe this realignment creates a more effective model for executing our business strategy, managing our performance, and, most importantly, serving our customers.

To close, we are pleased with this quarter's results, but we realize that we must continue to remain focused and find ways to optimize our franchise, in order to create long-term shareholder value. I'll now turn it over to David Turner, who will cover the details of our second quarter results. David?

David J. Turner

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

Thank you, and good morning, everyone. Let's take a look at the details starting with the balance sheet. We achieved another quarter of steady growth as loan balances were up $833 million or 1.1%. Notably, both our business and consumer lending portfolios grew, as total loan production increased 22%, reflecting an improving economy. The business lending portfolio totaled $48 billion at the end of the quarter, an increase of 1% from the prior quarter. The increase was primarily driven by commercial and industrial loans, which grew $888 million or 3%. C&I growth was led by our general industry's group within the geographies, as well as our asset-based and specialized lending groups. In particular, our technology and defense group achieved solid growth.

In addition, to the seasonal impact we typically experience in the second quarter, we are seeing an increasing number of commercial customers utilizing loans and lines to fund working capital, general financial needs, and to some extent M&A. C&I loan production increased 26% and line utilization increased 30 basis points quarter-over-quarter. Meanwhile, commitments for new loans increased $1 billion. While ending investor real estate balances were down slightly from the first quarter, average balances were up. We expect to benefit from some incremental growth over the remainder of the year in this important loan category.

Total consumer lending increased $206 million, linked quarter and represented 38% of our total loan portfolio at quarter end. The growth in the consumer portfolio was led by indirect auto lending. Both balances and production increased 5% from the prior quarter. With our focus on process improvement and the positive outlook for auto sales, we expect continued growth in this portfolio.

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Credit card balances increased $28 million or 3% from the previous quarter. This increase stems from a 14% increase in spending volumes and a 3% increase in new credit card sales. We expect balance growth to continue over the remainder of the year.

Mortgage balances were up modestly this quarter, as production increased 31% linked quarter and applications increased 18%. Also, mortgage pre-payments, typically linked to refinancing activity, slowed from the previous quarter. Originations continue to be driven by new home purchases and represented 76% of total originations. Total home equity loan balances declined $84 million, as loan payoffs continued to outpace new production. Total home equity production increased 32% from the previous quarter. Importantly, as customers' home values increased, they're taking advantage of both the fixed rate home equity loan product, as well as the variable rate home equity line product.

Our direct consumer lending portfolio totaled $1.2 billion at the end of the quarter, an increase of 4% from the prior quarter. We currently have several new initiatives and products under development that we anticipate will help further expand this portfolio over time. Looking ahead, based on what we know today, and reflecting our current economic forecast, we continue to expect 2014 loan growth to be in the 3% to 5% range.

Let's take a look at deposits. Deposits continue to grow, increasing by $429 million during the second quarter. Similarly, low cost deposits grew by $697 million, and continued to account for the majority, at 90%, of total deposits. Deposit costs remain at historically low levels and totaled 11 basis points, while total funding costs declined to 31 basis points in the second quarter. We continue to expect 2014 deposit growth to be in the 1% to 2% range for the year.

Let's take a look at how all this impacted our results. Net interest income on a fully taxable basis was $837 million, an increase of $6 million. The resulting net interest margin declined 2 basis points to 3.24%. Net interest income was positively impacted by loan growth, however, this improvement was offset by lower asset yields and loan spread compression, resulting from the persistently low rate environment and competitive pricing pressures. Regions has been able to maintain a relatively stable margin, primarily due to improvements in deposits and borrowing costs and due to the decline in rates that has persisted. Looking forward, we expect some modest net interest margin compression in the 5 basis point to 7 basis point range. However, we expect to be able to grow net interest income concurrent with loan growth.

We remain asset-sensitive and expect to benefit from increases in both short and long-term rates. Therefore, if the improvement in economic conditions translates into an increase in rates, we would anticipate a lift of both net interest income and net interest margin.

Let's move onto non-interest revenue. Total non-interest revenue increased 4% to $457 million in the second quarter. Service charges increased 1% from the first quarter, aided by an increase in checking accounts in the first half of the year. In addition, service charges are typically seasonally lower in the first quarter. Card and ATM fees increased 6% from the previous quarter. Debit card transaction volume increased 8% from the first quarter, attributable to higher spending and to growth in checking accounts. Credit card income benefited from a 3% increase in sales of new credit cards, as well as spending increases.

Now, with respect to our ready advanced product, as you recall, we discontinued offering this product to new customers in late January and existing customers will be phased out by the end of the year. While we were in this product for a short period of time, relative to some of our peers, we learned how to offer small dollar credit to our retail customers in a more effective manner. We will take this knowledge and build on our commitment to providing all of our customers with credit solutions that meet their needs. While, we don't know how many of these customers will avail themselves of our credit products, just to help you frame it up, the contribution from the

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ready advance product on a pre-tax basis was approximately $6 million this quarter. And to remind everyone, we have successfully dealt with many legislative challenges that have impacted our non-interest revenue to a greater degree than the ready advance product, which gives us confidence in dealing with these changes looking forward.

Let's turn to expenses. We continue to focus on controlling expenses and our results reflect those efforts. Adjusted non-interest expenses totaled $827 million in the second quarter, down 2% linked quarter. Salaries and benefits declined 3% from the first quarter, the majority of which was related to lower payroll taxes and benefits. In addition, year-to-date, we have reduced overall head count by 839 positions or 3.5%, primarily driven by our new branch optimization staffing strategy and the impact of recent branch consolidations.

Deposit and administrative fees declined $9 million, primarily related to a refund from previously incurred fees. Going forward, the run rate is expected to be similar to that of the first quarter. Although our adjusted efficiency ratio improved to 64.2%, we remain committed to driving continued efficiencies across the organization. We continue to expect full-year 2014 adjusted expenses to be lower than those of 2013.

Let's move on to asset quality. We continued to make progress in the second quarter as many credit metrics improved. Net charge-offs totaled $67 million, which represented 35 basis points of average loans. The provision for loan losses was $35 million or $32 million less than charge-offs. Our non-performing loans declined 16% linked quarter and inflows of non-performing loans declined 8%. At quarter end, our loan loss allowance to non-performing loans or coverage ratio was 137%. In addition, total late stage delinquencies declined 2% and troubled debt restructurings or TDRs declined 15%, driven by payoffs and pay-downs. And while total criticized loans increased from the previous quarter, classified loans continued to decline. And just to be clear, the results of the Shared National Credit Exam have been reflected in the results for this quarter. Based on what we know today, we expect favorable asset quality trends to continue. However, at this point in the cycle, volatility in certain metrics can be expected.

Let's move on to capital and liquidity. Our capital position remained strong, as our estimated Tier 1 ratio at the end of the quarter stood at 12.5%. Our estimated Tier 1 common equity ratio was 11.6%, an increase of 20 basis points from the previous quarter. We estimate our fully phased-in Basel III common equity Tier 1 ratio to be 11%, well above the minimum threshold. And liquidity at both the bank and holding company remains solid, with a loan-to-deposit ratio of 82%. Importantly, based on our understanding of the proposed rule, Regions remains well positioned to be fully compliant with respect to the liquidity coverage ratio.

Now, in summary, our second quarter results continued to build on the momentum established earlier in the year. We believe that by focusing on our customers, and by creating products and services that meet their needs, we will grow our customer base, deepen existing relationships, and strengthen the communities in which we operate. Furthermore, we continue to create and foster an environment that attracts and retains top talent, allowing us to not only better serve our customers, but also to successfully execute on our strategic priorities. All of which we believe will ultimately create long-term value for our shareholders.

Thank you for your time and attention this morning, and I will now turn it back over to List, for instructions for the Q&A portion of the call.

M. List Underwood

Head-Investor Relations, Regions Financial Corp.

Thank you, David. We are ready to begin the Q&A session. In order to accommodate as many participants as possible this morning, I would like to ask each caller to please limit yourself to one primary question and one related follow-up question. Now let's open the line for your questions, operator.

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Keith Murray of ISI.

Keith Murray
Analyst, International Strategy & Investment Group LLC

Q

Thanks. Could you just spend a minute on trends behind the service charge on deposits? Basically flattish quarter-over-quarter, down a little year-over-year. What's going on behind there?

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

A

From a service charge, Keith, this is David. Obviously, seasonally low in the first quarter. It generally picks up in the second. We have had a couple of things going on. First off, we're growing accounts, which is encouraging, but customer behaviors have changed as well. From what we see, customers are being more careful with how they manage their accounts, and that's reflected in some of the negative, in terms of our service charge line. We think the right thing to do is continue to create products and services that our customers need and will value, that is, they'll pay for what they get. And we believe the way to continue to increase the service charge line item is through that customer growth that we are seeing, and we have all of our associates focusing on growing that line item.

Keith Murray
Analyst, International Strategy & Investment Group LLC

Q

Okay, thank you. And then just on the loan growth guidance. It looks like you're calling for a little bit slower growth in the back half of the year versus the first half. Where are you seeing a little bit of declining momentum, category wise?

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

A

I'll answer it, and ask David to expand on it. But we forecasted loan growth in sort of that 3% to 5% range, and we still feel that's appropriate for us to forecast at, at this juncture. We are seeing credit demand more broadly than we've seen it in the past, which is an encouraging improvement. I would just say that we have seen increased competition in that space as well, both from banks and non-banks. And as that activity is taking place, we still believe that we're doing a great job of getting in front of customers. Our bankers are some of the best and we're winning a lot of the business. But, given what we're seeing now, from both a demand and a competition standpoint, we still believe our forecast is in line. David?

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

A

Yeah, we started, Keith, the first quarter, a really strong start. We went to several conferences and were asked why we're in the 3% to 5% range, when the run rate clearly would imply much larger. One quarter doesn't make a trend. Two quarters doesn't quite make a trend either, but as we look out and we see the demands for credit, larger corporate demand, still not seeing quite the small business demand that we'd like to see, and we're still cautious about being beyond the 3% to 5%. We want to make good loans, profitable loans. We are seeing no more today than we have been, as a result of some of the competitive pricing pressures and structures that we see. So right now, we still think 3% to 5% is the right number. We'll see what happens in the third quarter and update that on the next call.

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

Pipelines are robust. We still feel good about our pipelines. To David's point, the production, even in the small business sector, has been good, has been encouraging, but it hasn't resulted in a lot of growth in outstandings because of payoffs and pay-downs. But we still continue to see an awful lot of de-leveraging taking place out of bank debt. And while demand's picking up and we feel bullish about where the economy is going, we still are concerned about the level of competition and the level of alternatives for some of our borrowers.

Keith Murray
Analyst, International Strategy & Investment Group LLC
Q

Thanks very much.

Operator: Your next question comes from the line of Eric Wasserstrom of SunTrust Robinson Humphrey.

Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey
Q

Thanks very much.

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

Good morning, Eric.

Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey
Q

Good morning.

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

Good morning, Eric.

Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey
Q

Just wanted to follow-up on a couple of the forward-looking statements. With respect to your operating expense lines, if we were to simply annualize the first two quarters here, we'd end up achieving the guidance. So I guess my key question on this is, should we expect incremental improvements from the second quarter $827 million level?

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

As I mentioned in our prepared comments, we continue to focus on expenses every day, given the challenges and growing revenue. Our guidance has been year-over-year guidance, which we want to stick with right now, but every line item that you see and a lot of line items underneath what you see in our public financial statements, we are working hard on every single one of those. Obviously, the driver on expense management, the number one, our largest category is our salaries and benefits, occupancy. We continue to look at furniture and fixtures. But we're having savings in some areas and investments in others. We've invested an awful lot in regulatory compliance, given what's going on in our industry, and but I think we can continue to become more efficient. Our

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efficiency ratio is down quite a bit from last quarter. We have given guidance that we would continue to work to the lower 60's over the year. How low we can go, we'll have to see. A big part of that is really the revenue side of the equation, versus expenses.

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

Yeah. I would say also, David, when we're clearly focused on positive operating leverage, and while we have given guidance, our expenses this year should come in below last year's final number. We are focused on trying to deliver prudent growth, and to the extent that growth were to exceed our expectations, then, obviously, some of the compensation around that would also increase. But, right now, we still feel good about our guidance.

Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey **Q**

And on the salaries component, is there incremental head count reduction to come, or is that largely through at this stage?

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

Yeah. I would say the majority of the head count reductions that resulted in the rationalization of our branch staffing and also the rationalization of the number of the branches, those are in the numbers today. But we continue to look for efficiency opportunities across the company, and still confident in our ability to drive those efficiencies out. So, incrementally, there's still opportunity, but the parts you saw coming out of first quarter has had a lot to do with some of the branch rationalization work we did.

Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey **Q**

And if I may sneak in one more. I heard your comments on the asset equity outlook. But how, specifically, should we think about the adequacy of the provision at this level, down under the 1.4% range?

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

Are you talking about the allowance, the adequacy of the allowance?

Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey **Q**

Correct.

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

We have a pretty sophisticated model. We go through the exercise every quarter, in terms of determining what the allowance needs to be. We will continue to follow that. As credit quality continues to improve, in particular non-performing loans, TDRs and charge-offs, it gives us more confidence that the allowance level can come down some as well. Where that terminal value is, is very difficult for us to come up with. We had originally given the guidance on a range of 1.5% to 2%. We think we can go south of that number, given the improvement in our credit quality, but we have been reluctant to peg exactly where we think that can get to because it really depends on what our model tells us. And so, we're going to stick with that.

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Eric Wasserstrom
Analyst, SunTrust Robinson Humphrey

Q

Thanks very much.

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

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

A

Good morning, Matt.

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

Q

Good morning. If I could follow-up on the non-interest margin outlook for down 5 basis points to 7 basis points. I guess, first, to clarify, is that combined down 5 basis points to 7 basis points for the back half of this year?

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

A

That's down from where we are right now from the back half of the year. That's correct.

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

Q

Okay. So, in total, over two quarters potentially down 5 basis points to 7 basis points?

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

A

That's right.

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

Q

Okay. And then, I guess, just bigger picture. Why is there the margin pressure? I guess, if I look at short and medium term rates, they haven't really changed. Obviously the ten years come in. Is it some of the bond premium amortization or is it loan pricing or is it just that the shorter end of the curve hasn't moved up at all or all of them?

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

A

We expected the short rates to be where they are. Long rates, we have expected to rise a little bit towards the back half of the year. Still do. But the ten years' persistently lower. If you look at LIBOR, LIBOR is down lower as well, some. And I think it's just this continued reinvestment that we're having to make with our cash flows in the lower rate environment that continues to put pressure on net-interest margin. That being said, we continue to grow the loan portfolio like we think we can. We think net-interest income can grow commensurate with the loan growth that we'll have. So, from a competitive standpoint, we have – we've been relatively stable from the margin standpoint. I think our peer average that we track we're down about 6 points this quarter and we've done relatively well, but at some point we've got to – it's going to catch up to us from a NIM standpoint. We've had deposit growth that we've needed to deal with, which is a good thing, but you have extra cash flows put to work. Some of that sitting at the Federal Reserve where you don't get a lot of carry and it actually works against you from

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a NIM's standpoint. So, I wouldn't be overly focused on the NIM, but we are going to have the challenges just like everybody else will have and our focus is really on growing the net-interest income line.

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

Okay, that's helpful. And then just thoughtfully, the deposit advance product, that's gotten a lot of focus and I think at $6 million a quarter is materially less than people were fearing. Remind us, is that included in the service charge on deposit, and if so, has there already been a little bit of decline in that product, which is why the fees are flat or down a million year-over-year?

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

That's right, Matt. It's all in the service charge line and that as a result of the discontinuation of new clients coming in January, clearly, there's been some runoff there. That is reflected in the first and second quarter service charge line items, clearly a bigger impact in the second quarter than the first, given our timing, so that may get a little bit to Keith's point that he started with on service charges as well.

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

Okay, thanks.

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

Paul J. Miller
Analyst, FBR Capital Markets & Co.
Q

Yeah, thank you very much. On the troubled debt restructuring, your TDRs, we know that there's a pretty hot market for that stuff right now and some of your competitors have been selling assets into that. I know you sold some a couple of quarters ago, but I don't believe you sold any this quarter. Can you give me some thoughts are you going to let that portfolio runoff or is there opportunity to sell that at some pretty good prices today?

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

Yeah, I think, Paul, if you look at the transaction that we had in the fourth quarter, we closed in the first quarter was unique. We felt, given that pool of assets and pricing for that particular pool was the right thing for us to do. We continue to evaluate opportunities to sell assets, TDRs, when the economics make sense and when the trade doesn't make sense for us we're not going to do it just to unload troubled debt restructurings. If you look at our TDRs, there's a disproportionate amount of those that are paying us as agreed and accruing. We just have them in a TDR classification because they met the definition of a restructuring at the time. We do think that, in particular in the commercial side, we're seeing credit improve. You can see that in our metrics from classified to criticized assets as loans continue to improve and they've been upgraded to better categories. And so over time, we think some of those TDRs will be payoffs. Again, they're paying us as agreed so it will be payoffs, it'll be pay-downs. And it will be some that just get better and, upon renewal, those could go onto different classification. So, it's really about three or four things working there to help us improve TDRs but it's all about the number one driver is asset quality improvement.

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

Well, Paul, I think additionally, we look at the relationships we have with these customers. And many of these customers may be in a TDR status but they're paying as agreed and they have a deep relationship with our company and so we take that into consideration. But to David's point, we continue to look at this category that's on our balance sheet and try to make the best decision for what's best long-term for the company and our customers.

Paul J. Miller
Analyst, FBR Capital Markets & Co.
Q

And you don't take – I mean, you do take more of a capital charge with the TDRs, but you would rather take that capital charge if you can maintain a customer. Is that what you're basically telling me?

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

I think, to David's point, we look at the economics and the economics is not only of the trade, but the economics is the value of that relationship on an ongoing basis.

Paul J. Miller
Analyst, FBR Capital Markets & Co.
Q

Okay. Hey, guys, thank you very much.

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

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

Good morning, Ryan.

Ryan M. Nash
Analyst, Goldman Sachs & Co.
Q

Hey. Good morning, guys. So, just to ask Eric's question a little different way. When we look at expenses in the back half of last year, there was a pretty big ramp. So, I guess, assuming your base case of 3% to 5% loan growth, assuming that does happen, should we expect to see a ramp from the current levels? Or do you think you can continue to keep expenses close to where we are today?

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

Well, if you recall last year, Ryan, we were investing quite heavily in our Wealth Management initiative and we had hired a number of people towards the second half of last year really to get that initiative up and running and it made a lot of progress on that. But that initiative is funded today and so, depending on what the opportunities are in the last half, we can't predict those, but right now we're pretty pleased with where we stand from a staffing standpoint and absent any unforecasted opportunities to bring more talent into the company, we think we're where we need to be.

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Ryan M. Nash
Analyst, Goldman Sachs & Co.

Q

Got it. And then Grayson, just on capital, unless I missed it in the release, you guys have one of the highest capital ratios of your peers. Unless my math is wrong, it doesn't look like you guys used much of the buyback at all. And yet, last year, if I remember, you used over half of your authorization right out of the gate. So, can you talk about your decision to hold off on the $350 million or so buyback. I think we've seen a couple of others out there who have been constructive on the back half of the year utilizing large chunks early on, so I would be interested to hear your views on using capital.

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

A

Absolutely. Your memory's good as last year you remember we were fairly early in the process of executing buybacks and this year we've submitted a capital plan that's different than last year. We think we've done the right thing for our company, but it is a different plan than we executed last year. David?

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

A

Yeah, I think, Ryan, let me just go through steps on how we think about capital. Clearly, we wanted to get our dividend up, while use our capital for growing organically. We want to use our capital after that for growth of portfolios, growth of businesses, whether they be banks and non-banks. And when that manifests itself to return it to shareholders. So we submit our capital plan early January, based on our third quarter of last year. So, it's been a while. And we've put in there specific capital actions that we would like to engage, including the timing thereof. And without being too specific, we're executing according to the plan that we submitted to our regulatory supervisors that didn't receive an objection. So, you know what our buyback is. We've made that public and we will execute according to that plan.

Ryan M. Nash
Analyst, Goldman Sachs & Co.

Q

Got it. And if I could sneak in one other quick one. I know you noted that the SNC exam was in this quarter's results. I do think some of us were surprised that we did see a 24% increase in the special mentioned loans. Was this driven by the SNC exam? And, if not, can you just give us some color as to what drove the quarter over quarter increase?

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

A

You know, we can't comment specifically on regulatory activities. I tried to put that in my prepared comments that the results from that exam have been incorporated and what you see in our numbers. You also, as you look at the classified and criticized schedule that's in our supplement, you'll see the improvement in classified moving. Some of that improvement moved into special mention. So, net-net, if you look at them together, we're up I think about 2%. We're still encouraged by the path of our credit quality. There's nothing that causes us to believe that our credit quality is turning to go the other way, which I think is really what your ultimate question is.

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

A

As these credits migrate, you're going to see more credits move into that special mention category as that particular credit recovers.

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Ryan M. Nash
Analyst, Goldman Sachs & Co.

Q

Got it. Thank you for taking my questions.

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

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

A

Good morning, Marty.

Marty Lacey Mosby
Analyst, Vining Sparks IBG LP

Q

Good morning. Grayson, I want to ask kind of a strategic question. When you're looking at potential, kind of pockets of further recovery. I look at the excess capital that's being built and it's continuing to go higher. You've got excess liquidity to deploy at some point and you've got the rate sensitivity that's sitting there. Can you just talk a little bit about strategically how you think of these three things and how you're wanting to use those for the best benefit of your shareholders?

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

A

Yeah, I think, Marty, as David was trying to articulate just a moment ago, is that we've made a conscious decision to try to position our company in this way. We think it's to our strategic advantage to position ourselves this way. We do know that we've got some excess capital relative to peers. We do think we still have pockets of recovery that's still occurring in the markets that we operate in, and in the portfolios that we have on our balance sheet. We think that every quarter puts us in a little bit better position, and still confident and encouraged by the progress we're making. That excess capital, excess liquidity is certainly something we discuss and work through from a strategy standpoint. I think that as we put together our capital plan for this year, we tried to weigh those opportunities and what we thought timing of those kind of opportunities might be, and we put our plan together accordingly.

So, if those growth opportunities don't occur as we thought or don't occur on the timeline we thought, we'll make adjustments as we go forward, but right now we're pleased with how we're positioned. I anticipate questions on this issue, but we still remain pleased with where we're at.

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

A

Marty, I'll add from an excess capital standpoint, this gives us maximum flexibility to do some things. We realize that if whatever those things might be don't manifest themselves, that we can't continue to pile up capital and work against our return metrics and the fact that our common equity cost is still much higher than we want it to be. We get the message. We know, we have a plan for getting that deployed in a meaningful manner going forward.

From an excess liquidity standpoint, we're sitting here with a loan deposit ratio of 82%. We do have this new thing coming called the LCR, liquidity coverage ratio, that we all need to be very careful on what that means to our industry. It is a big change, and, of course, we don't have the final rules, but we feel confident based on what we see today that we're going to be fully compliant with that. But that will have a different liquidity profile when it's

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implemented than we do today, and so we need to be careful there. From an interest rate risk standpoint we are continuing to be asset sensitive. We would love for rates to increase some. Unfortunately, given the economy and given a lot of geopolitical issues, we don't know that we'll see that in 2014. We think perhaps we see that in the latter part of 2015. That being said, we think our balance sheet positioning is the right thing for us at this time.

Marty Lacey Mosby
Analyst, Vining Sparks IBG LP
Q

The other thing I was going to just kind of big picture is efficiency ratio, you made a lot of progress in getting that down from like 70% into the low 60%s. Traditionally, the low 60%s has kind of been where Regions has kind of plateaued. So you've made a lot of progress even compared to historically where you've been with the ability to show at least when revenues pop on rising interest rates. So it just seems like to me the operating leverage is getting to a point where you probably squeezed that pretty tightly and you're waiting on that next round to kind of get you down towards the 60% range?

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

Yeah, Marty, I think, we've worked very hard and made pretty solid progress on improving the operating efficiency of the company and a lot of progress on the expense side of the income statement. We've done a lot of things in terms of rationalizing our workforce and rationalizing our physical infrastructure. We reduced several million square feet of space. We've focused on a lot of process re-engineering to take a lot of the labor out of the different processes.

So, we feel pretty good about what – we feel encouraged by what we've done on the expense side. At the same time, we face some pretty big challenges in terms of revenue generation. There's been a number of regulatory and legislative activities that have challenged our – the revenue side of our income statement, and so if you look at our challenges today, it's much more apparent on the revenue side than on the expense side.

All that being said, we still are spending an awful lot of time and still finding opportunities to reduce expenses in our company and we'll continue to do so, but we likewise are spending an equal amount of time trying to figure out how we generate revenues inside our company. Obviously, an increase in the interest rate would be very helpful to our revenues, but to David's point we can't depend on that. We can't expect that to happen quickly, so we're finding other ways to do that. And we are growing households, growing accounts and growing the depth of our relationships with our customers and it's starting to make a difference.

Marty Lacey Mosby
Analyst, Vining Sparks IBG LP
Q

Thanks.

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

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

Good morning, Ken.

Kenneth M. Usdin
Analyst, Jefferies LLC
Q

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Hi. Good morning, Grayson. First question, just to follow up on the service charges. Thank you for quantifying the deposit advance. I was wondering if you could just help us walk through those changes in behavior that you've seen in other parts of the service charges, and maybe how much is related to changes on the overdraft side and then also just your further expectations about trying to help us size overdrafts. And with the – hopefully we'll get them someday, the expected rules – what type of potential impact we're still looking at there?

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

A

Well, I think it may be a challenge to our revenues, but I think it's good news for our economy. We're really seeing much more financial discipline out of the consumers who are banking with us. If you recall back several quarters ago, we were predominantly a free checking provider and we went to fee-eligible. So, 97%, 98% of our accounts today are fee-eligible based off of balances or transaction activity hurdles, and what we're seeing is people are managing to those requirements and doing a better job of that today than ever before. So they're carrying higher balances, and we also are seeing customers who are avoiding overdraft activities, and so you are just seeing better personal discipline around that.

It's interesting, you see the same thing on the card side, both the credit card and debit card. Spending is up, strong double digits on those cards, but balances on the credit side continue to be modest. So we would just continue to say that the economy of the consumer appears to be getting stronger and the financial discipline around those customers appears to be better as a result. A lot of the fees that we typically would have seen are not as strong as they were, but I actually think that's good news, and I also think that it bodes well for when deposit gathering franchises become valuable again. There will be a point when interest rates comes up and our ability to gather deposits is really the strength of this organization.

Kenneth M. Usdin
Analyst, Jefferies LLC

Q

Okay. Then secondly, on the Wealth Management side, just noticed two of the three lines looked pretty good, but the third line, the biggest one, the investment management trust fee income was a little light sequentially and year-over-year. So just wondering if you could give us an update on what either specifically what impacted that this quarter, and also your take-up in relative growth expectations for that Wealth Management business looking ahead. Thanks.

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

A

Yeah, Ken, I'll tell you, the Wealth Management line item that you referred to was down a little bit. I would tell you there's nothing systemic there. We can grow that and expect to grow that. We do that by executing our Regions 360 approach, which is making sure that our bankers that are out there with customers are taking the folks in our trust area to their client to continue to grow that. It has been slower than we want, but we really have a pr etty good focus on Regions 360 and expectations on our sales folks to perform consistent with shared value and the Regions 360 playbook that we've put together. So, we do think that will get back on track and growing. It was down just a little bit, so nothing really systemic.

Operator: Your next question comes from Gaston Ceron of Morningstar Equity Research.

Gaston F. Ceron
Analyst, Morningstar Research

Q

Hi. Good morning.

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M. List Underwood
Head-Investor Relations, Regions Financial Corp.
A

Good morning, Gaston.

Gaston F. Ceron
Analyst, Morningstar Research
Q

Just had a quick question to follow-up on the issue of competition for loans. Just curious, are you seeing the nature and, I guess the strength of competition; play out any significantly different this time entering other previous cycles that you've been through? And is there anything particularly unusual about how the competition is sort of ratcheting up here compared to other times that we've seen this sort of thing happen?

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

Yeah. I can't really say how differently this is from other cycles, necessarily. I think this one still is playing out. But what we're seeing is that, given the liquidity in the market, given the interest rate environments that, in particular, our upper middle market, corporate-type credits have a lot of alternatives. The public capital markets being one of those alternatives. And so, we're just seeing more customers taking advantage of the environment we're operating in, and I think the longer it goes on, the more competition we'll see. And so underlying all of that is, incrementally, more credit demand than we've seen in the past. We still are seeing strong pipelines for new business, but the competition around those relationships is as strong as I've ever seen it, and an awful lot of pressure on our bankers to get out in front of those customers and try to convince them of the value of our relationship. But, no doubt, there's a lot of competition, a lot of alternatives today.

Gaston F. Ceron
Analyst, Morningstar Research
Q

Okay. Fair enough, thanks. And then just very quickly, as a follow-up. I know you talked about some margin compression in the second half of the year here. I hear what you're saying about focusing more on growing NII than just looking at the margin. But just to follow-up on that, just curious. I don't know if it's too early to look into the first part of 2015, but would you have any expectations that, after this pressure in the second half here, that things might stabilize on the margin front in kind of the early part of 2015, or is it just too early to say?

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

Your two questions are more interrelated than you might have initially thought, because I think that when you look at the credit quality of the credits that we're putting on the books today, it's some of the best. A lot of our corporate customers, they have an awful lot of liquidity themselves and less debt than they historically carried. Their balance sheets are in much better shape, and so they've got a lower, from our standpoint, they've got a lower risk rating, a better credit quality picture, and can demand better pricing on credit. So, as long as the economy continues to improve, and as long as the credit quality of our borrowers continue to improve, it's going to keep placing pressure on the margin as new loans come on the books. And you saw that compression on loan yields this quarter. And I think that just sort of continues, as long as we're sort of on this glide path. Hopefully, at some point in the future, we start to see the interest rate environment modestly change upward.

Gaston F. Ceron
Analyst, Morningstar Research
Q

Thank you.

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

Erika P. Najarian
Analyst, Bank of America Merrill Lynch

Q

Yes, thank you. Good morning.

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

A

Good morning, Erika.

Erika P. Najarian
Analyst, Bank of America Merrill Lynch

Q

Morning. My first question is just on the LCR. As we look forward to the rest of the year and we think about balance sheet actions related to LCR compliance, do you plan to remix your current securities cash flows into HQLA, or should we expect the balance sheet to grow faster in the back half of the year? And also, does the NIM outlook for 5 basis points to 7 basis points, does it include any impact from LCR friendly balance sheet moves?

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

A

Hey, Erika. This is David. Our NIM outlook incorporates all activity, all actions that we would take. From an LCR standpoint, given where we're positioned, we have a relatively large securities book, today. We have reinvested some of our cash flows into different investment classes, like Ginnie Mae's. We have a corporate bond portfolio. We will recirculate some of those cash flows out of that portfolio into Ginnie's and to other high quality liquid assets. So you should not expect a significant change in our makeup, especially relative to some of our peers, and that's a little bit of the beauty as to where we are with regards to our loan deposit ratio and the size of our securities book, relative to some others.

Erika P. Najarian
Analyst, Bank of America Merrill Lynch

Q

Got it. And my second question is just a quick follow-up on credit. If we think about encouraging loan growth signs and improving loan demand from here, as well as credit that continues to improve, but we're probably along the bottom, how many quarters away do you think we are, in terms of provisions starting to match charge-offs?

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

A

Yeah, that's a really interesting question. You say we're here bumping along the bottom. I will say, we're encouraged by where our credit metrics have gone, but we expect them to continue to improve somewhat. The pace of which is a little uncertain. But today, we're at 35 basis points. 62% of our loan book is commercial. Our business services, I should say. And so, we think there's room to continue to come down, and it's that pace of charge-offs that ultimately dictate how much reserve release we have, and what, ultimately, our reserve levels need to be. So, I don't know that we've quite gotten to the bottom of the bump along just yet. And so, I think, look at one thing. Look at what our NPL's do, look what our inflows do, and look what our charge-offs do, to give you better information as to what a go-forward level might be.

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Erika P. Najarian
Analyst, Bank of America Merrill Lynch

Q

Okay, helpful. Thank you very much.

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

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

A

Good morning, Matt.

Matt H. Burnell
Analyst, Wells Fargo Securities LLC

Q

Morning, Grayson and David. Thanks for taking my questions. First of all, you mentioned that you're getting a little bit more demand for underwriting of home equity loans. Certainly makes sense, given the data that we've seen in terms of the improvement in home equity values. But I guess I'm just curious if you could give us a little more color as to how you're underwriting those, and if there's any regulatory guidance that is being imposed on you, in terms of trying to reduce the future rate shock on the HELOCs?

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

A

Yeah. First of all, we have seen a shift in our equity product line-up. We have both a line of credit and a fully amortizing equity loan product. You've seen a shift where there's more production now in the line product than the loan product. That's been a recent shift. I think an awful lot of the loan production, historically, has been interrelated to refinance. In particular, with people who have small dollar mortgages, relatively small dollar mortgages. And so as that refinance activity's gone away, so has that production. And so, the line product is, you're seeing more production out of it. That production has been helped by the home appreciation values that we've experienced over the last several quarters, but still being very conservatively underwritten and much more conservatively underwritten than what you would have seen previous to the economic recession. And so, we changed a lot of our product features, as well as changed a lot of our pricing around those features. And we, in addition, have changed a lot of our underwriting criteria, in terms of loan to value. And if you look at the quality of that book, and I can't state it off of the top of mind. David may can. Is that the loan to value ratios are very solid. The credit scores we're seeing on it are north of 700, and we have – the product does begin amortizing. I believe if I'm right, it's a 10/10 product. Ten years interest rate, ten years of amortization. And so we feel good about the product that we're underwriting, from a regulatory compliance perspective. And I think the new LTV is averaging around 60% on new production.

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

A

I'll add a couple of things, Matt. We were a little different than most others going into this, into the recession, relative to this product, where we had, basically, a 20-year IO. We stopped that to have a 10/10 product, as Grayson mentioned. The benefit, if you will, of having that is, if you look at page 13 of our supplement, you'll see that future maturities of the home equity lines of credit, we've broken down in first and second liens, and you can see what the resets are. They really don't even start until 2019, and the bulk of these are in 2026. As a matter of fact, if you look at 2014, our resets are $128 million, $195 million next year. So we don't have the payment shock issue in the near-term like some others have.

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I'll also point you to page 11 in the supplement where, if you look at our credit quality, our improvement was pretty noticeable with regards to our home equity product. In particular, if you look at second lien improvement, in terms of charge-offs. So that product's performing very well. The credit quality has been well. Our pricing of that product before the changes, when we grew the portfolio, were a little challenging, as we used a prime minus a half and prime minus one. So that's been our bigger issue versus credit quality or payment shocks.

Matt H. Burnell
Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you for that information. And then just in terms of the -- a number of your competitors have mentioned this quarter about not just looking at net interest margin, particularly on the commercial relationships. We and the analyst community have to look at the broader relationship and the fee revenue component that each relationship brings in. But if I look at that in terms of just the second quarter, and maybe this is too short a view, year-over-year capital markets fee revenue is down a little bit, year-over-year commercial credit fee income is down a little bit year-over-year. How are you thinking about growing those types of fees to improve the overall profitability of your corporate relationships? Presuming rates don't really move up much before the end of 2015.

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

A

Yeah, that's a good question. We've continued to make investments in our Capital Markets Group for that purpose, to continue to bring in new clients for us. We have new capabilities, in terms of underwriting there, that we started about a year ago. And I think if we stay focused, the capital markets fees, while we're focused on that, the interest rate environment is a big driver. A lot of those fees are really driven by some of our derivatives that we sell into the market, interest rate swaps to be more specific. And when you have a rate environment that, as low as it is, with no real expectation for increases, clients are reluctant to lock in, so they'll just take the interest rate risks themselves. That will change in time and when it does you'll see that manifest itself in our capital markets income.

If we have other income streams we continue to work on. You mentioned the relationship. This is maybe the single most important thing to take from our company is we are a relationship bank. We have Regions 360, which means taking our entire bank to our client base. You cannot be just a credit only shop. We have other products, Treasury Management, Capital Markets, whatever the case – Insurance. We have other lines of business that our customers can use, and so it's really understanding the needs of our customer base and taking those alliances of business and product and services and delivering those to the needs of the customer. That will be the differentiator for us over the long hall.

Matt H. Burnell
Analyst, Wells Fargo Securities LLC

Q

Okay, thanks for taking my questions.

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

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

A

Good morning. Gerard. Gerard?

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Thank you. Thank you very much. Good morning.

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In terms of your loan growth, you gave us some color that you expect loans to grow in that 3% to 5% range, and you talked about competition more recently being very strong. I guess the question I have though is your commercial real estate portfolio, both the investor-owned and owner occupied, which has always been a strong part of your business, continues to steadily decline. And it's not just this quarter, of course, as you know. And I know you were de-risking the portfolio and that program I was under the impression was completed, so I guess is what is happening to that portfolio as it continues to shrink? Is it something you just want to be smaller in that business or what's going on there?

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

A

Not at all. I would tell you that production on investor commercial real estate side has been pretty strong. And we continue to believe there's opportunities to grow that portfolio we obviously got to do that prudently and thoughtfully. But we're out finding ways to grow that portfolio every day.

The owner-occupied segment of that, just for clarification, is heavily influenced by small business and medium-sized businesses. And a lot of this is the facilities that they're operating out of, and that portfolio continues to amortize and to pay down over time. We got a lot of work that we're trying to do internally around those particular lending segments to try to encourage that and we're seeing good production.

But I would tell you of all of the customer segments we look at that small business, that small to medium-sized business, has been sort of late to recover, late to come back and have a lot of demand for credit. The stronger demand is up in the upper middle market, larger corporate customers, and the consumer has been fairly strong, especially in the area of Auto. But that small to medium-sized business, while we're seeing better production, we really still need to see – to get a really healthy economy, really need to see that customer segment strengthen a little bit more and develop a little more confidence to invest in their businesses. And that's predominantly driving that owner-occupied category.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Thank you. And regarding, I know you guys have touched on the capital. Obviously, your Tier 1 common ratio is very strong at 11%. If I recall in CCAR, your CCAR stress test, I think, reduced your Tier 1 common ratio by about 280 basis points. And since 5% is obviously the bogey everybody has to get to, I would think most banks would want to stay around 8.5%, not to get anything close to that 5% in CCAR.

What is your guys' thinking on where that Tier 1 common ratio should get to? And I know you have got different strategies of how to use the excess capital, but I'm more asking about what level do you think you should be at under a normalized environment when rates come back a bit and maybe growth picks up a little more?

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

A

Gerard, this is David. You're right on the stress basis that, if you look at our portfolio makeup at that time, we think that our improving credit metrics is a part of it, our TDRs. There are elements about our balance sheet that consume more stress than we have in the past. If you look at where we think Tier 1 common could go at Basel I, you would be in that 8.5% to 9% range. And clearly, we're well above that, and that goes back to the excess capital question that was asked by Marty. And how do we really get that deployed in the most efficient, most effective manner.

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So, we're looking at alternatives today, but we do think we have capital to spend on a host of things, not only total capital, but we need to optimize our capital stack in terms of making sure we have the proper amount of common and the proper amount of non-common Tier 1 as well. So there's still some things that we're working on to get capital levels and the stack optimized.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Not to pursue what those strategies are, but is there a timeframe that you think you could get to an 8.5%, 9% level? Is it end of 2016? Or is it sooner or later than that?

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

A

That's a great question. That's a little harder to answer. I don't think you'll snap your fingers and get to that level overnight. I do think it's something over time. I think the first thing we want to do is not continue to accrete capital at the level and pace as to what we've been doing and to get that deployed in a more effective manner.

So, let's do that first and then look at what options are out there for us to take advantage of with our capital mix. We think that gives us a lot of flexibility to see how things transition in our industry, to be able to allow us to use that capital, and so I don't want to make any commitments as to – really at the level, I gave you kind of a rough range, but certainly don't want to give you a timeframe. We need to leave that open ended.

Gerard S. Cassidy
Analyst, RBC Capital Markets LLC

Q

Thank you, I appreciate it.

Operator: Your next question comes from Richard Bove of Rafferty Capital Markets.

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

A

Good morning, Dick.

Dick X. Bove
Analyst, Rafferty Capital Markets LLC

Q

Good morning. It's been a long call, so if you want to do this offline, that's fine. But I was wondering if you could go through the process in this auto sector. We had this article in the "New York Times" last Saturday, it was pretty negative. And what I'm thinking about is, are you adding new car dealers or used car dealers? Are you letting the dealer underwrite the loan? Are you checking the premium that the dealer is putting on the rate? Are you looking at the price of the car that is being sold, relative to some kind of blue book situation to determine whether the dealer is gouging the customer? I mean, how are you approaching this whole new process in the auto sector?

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

A

I'll take the – clearly a lot of attention on this particular customer segment and we spend a lot of time on this segment from a compliance perspective, and in fact we've actually reduced the number of dealers that we're operating with. We – it's in our disclosures, but we actually have reduced our number of dealers we're dealing with by about 300, approximately 300. So we've gone through and rationalized which dealers that we're getting a

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healthy amount of business from, and getting it in a correct manner. A lot of dealer oversight, a lot of dealer monitoring around rates and spreads and adjustments to those rates and spreads. And so you'll continue to see us elevate our monitoring capabilities of that segment to make sure that we're adequately addressing compliance issues.

In addition, we're using a lot of third party reviews, third parties to come in and look at that and compare the numerics and make sure that we understand exactly what is going on, dealer by dealer and loan by loan. Be glad to have some of our team who's working on that full-time to give you more detail around that. But it's a complex endeavor and we're investing the time and energy in there to make sure that we're doing this in a responsible way.

Dick X. Bove
Analyst, Rafferty Capital Markets LLC

Q

Okay, thank you very much.

Operator: Your next question comes from Chris Mutascio of KBW.

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

A

Good morning, Chris.

Chris M. Mutascio
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Good morning. Thanks for taking my question. I wanted to ask the provision question maybe a little differently, David, if I could. Did the inflection in the loan loss provision expense this quarter have anything to do with the spike in the special mention category?

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

A

I would tell you that our allowance model certainly takes into account our risk ratings that we have, which would include special mention, substandard, and so forth. By definition it is incorporated into our provisioning and allowance levels that we established.

Chris M. Mutascio
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, thank you.

Operator: Your final question comes from John Pancari of Evercore.

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

A

Good morning, John.

John Pancari
Analyst, Evercore Partners (Securities)

Q

Good morning, Hi. Thanks for taking my question. Sorry for the long call here, but back to the deposit fees. I guess this goes back to Ken's question, which might have been looking at getting at is, have you been able to quantify a

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potential impact from check order processing changes? I know you've made a big step in helping us with the quantification of the deposit advance products. I wanted to see if you've got a similar quantification on the sequencing? Thanks.

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

A

John, this is David. We continue to see how this issue is going to evolve. We know this has been pushed off a little bit and it's probably a late 2015, 2016 issue. We are continuing to do what we think is the right thing to do by our customers. We are going to test a few things, starting in the first part of 2015. Because it's not just check order processing or debit processing order. It's got deposits. It has funds availability. There are a whole host of things that have to be considered in this, and that's why it's difficult to pinpoint specifically what it would mean. What we do believe is we will learn from some of our tests in the first part of 2015, and as we get better guidance we will share that with you. But we don't see this being an impact in 2015 as much as it might be in 2016, and that's depending on whether or not we come up with further guidance.

John Pancari
Analyst, Evercore Partners (Securities)

Q

Okay, thank you on that. And then separately on the excess capital discussion, can you just give us a little bit of your thought process around if M&A is part of your plans and is that potentially more focused around business acquisitions or loan portfolio acquisitions or could it be whole bank deals? Thanks.

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

A

Yeah, as I've tried mentioning our thought process, I'll go through the beginning of it, because it's important to know our whole way of thinking is we got our dividend up some and we continue to challenge to make sure we have a fair and reasonable dividend given the limits and guidance by regulatory supervisors. We then look to deploy our capital organically, growing earning assets at our company. We also look to use that for acquisitions of portfolios like we did our credit card portfolio a couple of years ago. We look at non-bank transactions that would give us sources of revenue without utilizing a lot of capital that would help us from a diversification of revenue stream, and we look at and have a whole team that looks at banks as well, if and when that ultimately comes back. So we're going to prepare ourselves for that type of transaction. When all that doesn't work, then we'll return that excess capital back to the shareholder in a prudent manner, subject to capital plans and no objections from our regulatory supervisors in the CCAR process. I guess the short answer would be yes it is included but that's the order that we think about in capital deployment.

John Pancari
Analyst, Evercore Partners (Securities)

Q

Okay, thank you. And then lastly here. On the commercial real estate front, to help support growth there, any possibility or any thought process around extending the duration a bit of your CRE paper that you're putting on the books in order to drive volume growth. For example, in competing more aggressively with some of the permanent financing players, for example?

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

A

We've talked about whether or not that's viable for us to date. We have not done anything to extend that duration. You can see kind of what our portfolio looks like right now. And it really is dependent on what type of risk adjusted return we can get on this product, what our stress capital looks like on this product. And so, I think that if

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we really looked at that, the first place we would look is really in that owner-occupied real estate space, where we have a little different client makeup, as Grayson mentioned earlier. Usually, a smaller business that's put up real estate as collateral out of an abundance of caution in many cases. And we're willing to take a little bit of duration risk with that. But I can tell you, to date, we haven't done a lot with it.

John Pancari
Analyst, Evercore Partners (Securities)

Q

Okay. Thank you.

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

A

Okay.

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

Thank you. I believe that's our last question. We appreciate everyone's time and attention today. Thank you and if there's any questions after the call, feel free to call List Underwood and Dana Nolan, who'll be glad to take your call. But thank you very much for being here today. Thank you.

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

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