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Regions Financial Corp. (RF)

Q4 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'll be your operator for today's call. I would like to remind everyone that all participants online have been placed on listen-only. [Operator Instructions] I will now turn the call over to Mr. List Underwood to begin.

M. List Underwood

Head-Investor Relations

Thank you, operator, and good morning, everyone. We appreciate your participation on our call this morning. Our presenters today are Grayson Hall, our Chief Executive Officer; and David Turner, our Chief Financial Officer. Other members of our executive management team are present 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 section of the presentation. Grayson?

O. B. Grayson Hall

Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

Thank you, List, and good morning, everyone. We're pleased you could join us for this morning as we review our fourth quarter and our full year 2014 results. This quarter, we reported $195 million of net income available to common shareholders, bringing our full-year results to $1.1 billion of net income available to common shareholders, and earnings per diluted share of $0.80, an increase of 4% over 2013.

Included in the earnings are some unusual items, which David will address in his remarks. Overall, these results reflect steady progress in 2014 as we continue to focus on the fundamentals of banking and meeting customer needs through service and innovation, while maintaining a prudent and disciplined risk culture. In 2014, we grew loans and deposits, we expanded our customer base, we prudently managed expenses, we improved asset quality and improved our capital ratios.

Loans increased a total of $3 billion or 4% during 2014. Concordantly, this growth was broad-based with both the business and consumer loan portfolios increasing. In 2014, deposits increased $2 billion or 2%, while deposit costs reached historic lows. Through the successful execution of Regions360, which is our prescriptive approach to relationship banking, the number of quality households increased, and we grew the number of checking, savings, credit card and wealth management accounts.

We believe this growth positions us well as we head into 2015. We remain focused on achieving operational efficiencies and reduced full-year expenses on an adjusted basis by 2% from the previous year. An example of our efforts, during the fourth quarter, we made a decision to consolidate 50 branch offices or approximately 3% of our network in locations across our markets. Over time, we expect to add branches in higher opportunity markets such as St. Louis, Atlanta, Houston and New Orleans. Through improved technology, these smaller branches will employ different staffing models and will be far more efficient. In 2014, our asset quality continued to improve, reflecting our continued prudent risk discipline practices. In fact, all our credit metrics experienced improvement in 2014.

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As a result of this progress and exciting improvement in our overall risk profile, we received positive rating actions from four major credit rating agencies this past year. Also during 2014, our capital return to shareholders totaled approximately $500 million. This included an – increased our quarterly dividend, as well as share repurchases. With respect to future capital deployment, as you're aware, we submitted our capital plan earlier this month and expect to receive the results sometime in March. Clearly, we believe that our capital position is sufficient to support both return of capital and strong organic growth. With that said, returning capital to shareholders is a top priority, and given the strength of our current capital levels, we believe it's appropriate to increase our total payout ratio. In 2015, in addition to effectively deploying capital, we remain committed to generating positive operating leverage and keenly focused on revenue diversification.

Shifting to the economic environment, I want to talk briefly about the recent declines in oil prices and its impact on our energy-lending portfolio. We are closely monitoring the price declines for direct and indirect impacts to our overall loan portfolio quality. Our bank has extensive energy lending expertise dating back multiple decades and through numerous energy cycles. Our core exploration and production loans at present are well-secured and provide collateral cushion to withstand price declines. In terms of broader impact, we have been monitoring markets such as Texas and the Gulf Coast for signs of weakness in employment and housing. However, we're not seeing any material weakness at this point in time. We have provided additional detail regarding our energy portfolio in the appendix of the earnings presentation.

As we look ahead, we expect improved growth in the U.S. economy in 2015. Low energy prices should provide a tailwind to consumer spending and the manufacturing sector. However, an uncertain global growth environment does pose some risk. As a result, we continue to expect an increase in short-term rates in the latter part of 2015. With that, I'll turn it over to David who will cover the details of the fourth quarter. David?

David J. Turner, Jr.

Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

Thank you, and good morning, everyone. I'll first take you through the fourth quarter details and then wrap up with the expectations for 2015. Loan balances totaled $77 billion at the end of the fourth quarter, up $700 million or 1% from the end of the previous quarter. Business lending finished the year strong, totaling $48 billion at the end of the quarter. This was an increase of $524 million or 1% from the third quarter as production increased 18%.

Commercial industrial loans grew $875 million or 3% from the prior quarter. This growth was driven by our Specialized Industries group, as well as Regions Business Capital. Importantly, line utilization increased 40 basis points, commitments for new loans increased 3%, and our pipelines remain strong.

Regarding investor real estate, ending balances were relatively steady from the previous quarter at approximately $7 billion. As we have previously stated, investor real estate remains an important part of our corporate bank strategy, given our market presence in the Southeast.

Moving to consumer lending, loans in this portfolio increased 1% linked quarter. Growth in the consumer portfolio was led by indirect auto lending as balances increased 3% from the prior quarter. While we benefited from the robust market for auto sales, process improvements instituted earlier in the year also contributed to the growth.

Credit card balances increased $45 million or 5% from the previous quarter. This improvement was driven by a 6% increase in spending, as well as a 3% increase in active card holders. Mortgage balances were up modestly. Meanwhile, total home equity balances were down slightly as the pace of loan payoffs was slightly higher than new production. Total home equity production increased 10% from the previous quarter as customers continued to

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take advantage of lower rates on variable home equity lines of credit. This quarter, other consumer loans were up just over 1% as a result of the introduction of several new products and improved customer delivery.

Let's take a look at deposits. Supported by our multi-channel platform, total deposits continue to grow, increasing $70 million during the fourth quarter. Of note, low cost deposits grew by $242 million and continue to account for 91% of total deposits. Deposit costs remained at historically low levels and totaled 11 basis points, while total funding costs declined to 29 basis points in the quarter.

Let's take a look at how this impacted our results. Net interest income on a fully taxable basis was $837 million. Net interest margin was 3.17%, a decline of 1 basis point from the third quarter. Despite a continuation of the low rate environment, which exerted pressure on asset yields, both net interest income and net interest margin remained relatively stable with the previous quarter. Stability in both measures was largely attributable to higher average loan balances and lower cash balances.

Total non-interest income declined $30 million or 6% in the fourth quarter. Service charges declined $14 million from the previous quarter. Now, this was primarily due to a $4 million decline in fees resulting from a product discontinuation in the fourth quarter. Additionally, there was an $8 million reduction in revenue related to customer reimbursements.

Mortgage income was down $12 million from the previous quarter, primarily due to lower gains from loan sales and a decline in the market valuation of the mortgage servicing portfolio net of hedging activity. In the fourth quarter, we purchased servicing rights on $833 million of loans, bringing our total servicing portfolio to $40 billion. We have the operational capacity to take on additional servicing volume and we'll continue to look for opportunities to add volume to our servicing portfolio.

While mortgage production declined in 2014, the pace of our decline was less than the industry. Originations continued to be driven by new home purchases and represented, on average, 70% of total originations in the fourth quarter. Based on what we know today, we expect mortgage production in 2015 to exceed that of 2014.

Capital markets income decreased $4 million quarter-over-quarter, driven primarily by credit valuation adjustments on interest rate swaps. Absent these adjustments, capital markets income increased slightly from the prior quarter. As we continue to build out our capital markets capabilities, we believe that syndications in real estate capital markets represent opportunities for us.

Card and ATM fees increased as a result of higher spending and transaction volumes, and wealth management income also increased as the company continues to expand and deepen relationships with new and existing customers. While we have experienced headwinds as it relates to non-interest income growth, we have several initiatives currently underway to offset these pressures. And as Grayson mentioned, throughout 2015, we will focus on diversifying our revenue.

Let's move on to expenses. Total expenses in the fourth quarter were $969 million, an increase of $143 million, which included some unusual items. And as a reminder, during the third quarter, we benefited from a recovery of expenses related to unfunded commitments of $24 million. This was partially offset by expenses related to Visa class B shares sold in prior years, which resulted in $7 million of additional expense in the third quarter.

As Grayson mentioned, we intend to consolidate 50 branches in 2015, and incurred a related expense of $10 million during the fourth quarter. We expect to incur additional related expenses of approximately $15 million in the first quarter of 2015 related to this consolidation. Also, at the end of the quarter, we recorded an accrual of

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$100 million for contingent legal and regulatory items related to previously-disclosed matters. And although you may have additional questions, please recognize that we cannot comment beyond this disclosure at this time.

Salaries and benefits remained flat from the previous quarter, although head count increased 124 positions. Importantly, the majority of these positions are revenue generating or revenue support roles and will drive future growth in revenue. Additionally, we had incremental hires in capital planning and risk management this quarter. However, at this juncture, we believe that hires of this nature are substantially complete.

Total credit expenses remained low. However, fourth quarter expenses increased slightly as the benefit related to gains from our held-for-sale portfolio diminished as balances declined, along with a seasonal uptick in OREO property tax expense.

Outside services increased due to third-party engagements to support risk management and capital planning functions. However, these third-party expenses should begin to subside, and I'll talk about that in just a minute. We remain diligent with respect to expense control, but we have opportunistically invested in talent and technology to further accelerate our momentum to grow revenue.

Let's move on to asset quality. Our overall asset quality remains solid as most credit metrics improved in the quarter. Our non-performing loans, excluding loans held for sale, declined 1% linked quarter. In addition, at quarter end, our loan loss allowance to non-performing loans or coverage ratio was 133%. Compared to the third quarter, total delinquencies declined 11% and troubled debt restructuring, or TDRs, declined 6%. In addition, both criticized and classified loans declined from the prior quarter. Net charge-offs totaled $83 million, representing 42 basis points of average loans. The provision for loan losses was $8 million or $75 million less than net charge-offs. And 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. We continue to maintain industry-leading capital levels. At the end of the quarter, our estimated Tier 1 ratio stood at 12.5%, and our estimated Tier 1 common equity ratio was 11.6%. Further, we estimate our fully phased-in Basel III common equity Tier 1 ratio to be 11.1%. During the quarter, we repurchased $248 million of stock as part of the board approved program that totals $350 million. We expect to complete this program during the first quarter of 2015. And liquidity at the bank and the holding company remains solid, with a loan deposit ratio of 82%. And regarding the liquidity coverage ratio rule, Regions remains well positioned to be fully compliant with the January 2016 implementation.

Now, throughout 2015, we'll update customer agreements to include LCR-friendly language, we'll modify existing deposit products, and we also plan to create new products and services to complement our strong position of high-quality liquid assets. And it's important to note that no major balance sheet initiatives are necessary in order for us to be compliant.

I now want to take a few minutes and touch on our expectations for 2015. With respect to loans, we expect total loan growth in the 4% to 6% range. Commercial and industrial loans are expected to drive loan growth within the business lending portfolio. Also, we believe that investor real estate portfolio has reached a point of stabilization. However, growth will be limited as we remain committed to our risk tolerance levels as it relates to this portfolio.

Looking at the consumer lending book, we expect continued growth from indirect auto lending. We plan to continue to focus on driving better pull-through rates, increasing margins, and improving overall credit profiles. Additionally, we're focused on expanding lending through online and point of sale financing alternatives directly and through partnerships with third parties. As a result, we expect the pace of growth in the other consumer category to accelerate in 2015.

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And moving on to credit card, to date, our marketing efforts have primarily targeted our existing customer base. As a result, our penetration rate is up 190 basis points over the last year. This increase, coupled with an increase in sales of new cards, should drive balance growth in the near term.

We expect incremental growth in mortgage balances during 2015 as the pace of production should more than outpace refinancing activity. From a production perspective, consumer lending closed the year on a strong note. In fact, December was the strongest single production month of the year.

With respect to deposits, balances should grow at a similar rate as 2014. As a reminder, a significant portion of our deposits are made up of individual deposits, which tend to be more granular and smaller in size, which, based on our research, should be more stable and less rate sensitive in a rising rate environment.

With deposit costs – deposit and funding costs expected to remain stable at historically low levels, there's limited ability to offset the continued effect of the low rate environment on margin. That being said, the net interest margin would be expected to remain stable to trending higher in a moderately rising rate environment in 2015.

And if current market conditions prevail, the net interest margin expected to remain relatively stable next quarter. However, with rates at current levels, the net interest margin would experience gradual pressure over the year. For example, if the ten-year treasury yield were to remain in the 1.75% to 2% range throughout 2015, we would expect 10 basis points to 12 basis points of margin pressure.

From an NIR standpoint, we expect this line item to grow in 2015, resulting from our investments that we have made in wealth management and in our corporate bank. Specifically, we made investments in insurance, investment services, institutional services and private wealth management. Additionally, our investments in capital markets, Fannie Mae DUS as an example, and new hires related to our power and utilities, and financial services teams and treasury management corporate bank are expected to pay off in 2015.

And finally, mortgage should have a stronger 2015 than 2014. From an expense standpoint, we will continue to focus on all costs. Our largest categories, salaries and benefits, occupancy, and furniture and fixtures, will be areas of focus in 2015. In addition, third-party consulting cost is another area where we have opportunities to reduce those expenditures. All in all, we expect to generate positive operating leverage for 2015.

Now, let me close by saying that 2014 was a year of solid progress, and we are diligently focused on executing our strategies as we head into 2015. With that, we thank you for your time and attention this morning. And now, I'll turn it back over to List for instructions on the Q&A portion of the call.

M. List Underwood
Head-Investor Relations

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

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QUESTION AND ANSWER SECTION

Operator: [Operator Instructions]

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee — A

Good morning, Erika.

Erika P. Najarian
Merrill Lynch, Pierce, Fenner & Smith, Inc. — Q

Good morning. I just heard you loud and clear in terms of your NIR guidance for the year, but I was wondering if we could get a little bit of clarity on the starting point. And this is the first question. Is the $4 million decline in fees resulting from product discontinuation, the final impact from that discontinuation? And is it fair fo r us to add back the customer reimbursements of $8 million and the CVA adjustment of $4 million back to the $448 million?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee — A

Erika, the discontinuation of $4 million, there's about $3.5 million left there, and that'll be done. And the – yes, the $8 million should be nonrecurring, so that is – your conclusion is appropriate there.

Erika P. Najarian
Merrill Lynch, Pierce, Fenner & Smith, Inc. — Q

As we – yeah, in terms of your guidance for positive operating leverage, if the ten-year does stay between the 1.75% to 2% range and the Fed doesn't move, can you continue to chop away at the efficiency ratio? I think on a core basis, I calculated 66.8% this quarter.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee — A

Yeah, I mean, Erika, I think that if rates were to stay where they're at and the Fed does not raise rates this year, obviously, we got to manage to that possibility. And as David said earlier, we're focused on remaining very disciplined and very keenly focused on opportunities to continue to rationalize our expenses across the company. We'll have – continue to do that, and we think we've proven that. If you look backwards in terms of how we've managed expenses, moving forward, obviously, in this rate environment, it means that we've really got to raise the bar, if you will, on that activity. And I think you should continue to see us look at ways to ra tionalize expenses across the franchise. As we had mentioned, we had announced the closure and consolidation of 50 offices. I think since – if you look back over the past few years, we've reduced our physical footprint some 20%, as well as attacked expenses across the franchise and across channels. David, anything to add?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee — A

I think we have to continue to look at our total business in terms of expense management under any scenario, any rate environment. We do believe that there's a tendency to have short-term rates go up towards the back end of

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the year still. We believe that's what the Fed wants to do, but we have to be prepared in case that's not the case. And so we're committed to seeking positive operating leverage in any scenario. It gets harder if rates stay lower.

Erika P. Najarian
Merrill Lynch, Pierce, Fenner & Smith, Inc.

Q

Thank you for taking my questions.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, John.

John Pancari
Evercore Partners, Inc. (Broker)

Q

Good morning. I wonder if you can you give us a little more color on the 2015 margin outlook. Is that expectation for 10 basis points to 12 basis points of a compression, is that incremental off of the fourth quarter margin number? In other words, from this fourth quarter 'til the fourth quarter 2015, or is that full-year 2015 margin on an average basis versus the four-year 2014 margin?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

That's really leveraging, John, off the fourth quarter where we are right now. And that would be – the impact of that really would be felt later in the year versus the earlier in the year; again, to the extent that that's a sustainable 1.75% to 2% throughout 2015.

John Pancari
Evercore Partners, Inc. (Broker)

Q

Okay. And you just alluded to what my follow-up was going to be on the margin. So therefore, if that's the case, the Fed does nothing, next quarter you've got a flattish margin; however, from the second quarter, third quarter and fourth quarter for 2015, you expect 10 bps to 12 bps of compression during that period. So what is implying that drop-off? Because that does imply a pretty good down-tick from here.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, I think we continue to see the negative impacts of lower rates on reinvestment yields in particular, where we're having to put to work $300 million to 400 million dollars of cash every month. And you can continue to see the rollover effect of lower rates in the loan book as well. So we think that if you look at where we think the Fed's going to be towards the middle of the year, we think you'll start seeing some pressure to increase short-term rates. And so we haven't abandoned that. What we wanted to try to do is put some sensitivities in to the extent that that does not happen and that the 10-year or longer rates also stay lower. So we're not saying that's what will happen or that we expect that to happen, we were just trying to give you a little bit of sensitivity on possibly what could happen.

John Pancari
Evercore Partners, Inc. (Broker)

Q

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Okay. Thank you.

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

Kenneth M. Usdin
Jefferies LLC
Q

Hi. Good morning. David, just a follow-up on the expense side, understanding the clear focus on operating leverage, last year you were able to also help us understand the directional dollars on the expense side. So – and you did a really good job of getting it down to in change percent. So with all these pushes and pulls and wanting to leave the door open on investments though, can you help us frame an understanding of where you think expense dollars can go, given that premise of the uncertainty on the revenue side?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

We think, Ken, we've made investments in a number of areas this year because we really – we believe growing revenue is important for our franchise. We've hired people to do that. We've hired some late in the year. They'll have the full run rate going forward. We have the negative impact of pension that will hit us for 2015. That's about $25 million in total for the year, so call it $6 million per quarter. So with that and the investments we've made, we're talking about expense management and revenue together in terms of positive operating leverage versus a commitment on just expense levels because we've needed to make the investments to grow revenue. We think they'll pay off and so I guess the best I can do to describe where you want to go is that positive operating leverage is something that we should be able to achieve in 2015.

Kenneth M. Usdin
Jefferies LLC
Q

Okay. Got it. And then on the fee side, just coming back to also expecting growth there, I'm assuming that's off of your adjusted [ph] 1784 (29:54) base. But what I wanted to dig down into is that I'm assuming that's inclusive of the $3.5 million of that lingering deposit advance runoff. And then also, can you just remind us, is it also inclusive of the expected overdraft charge changes as well?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

It does. It includes both of those.

Kenneth M. Usdin
Jefferies LLC
Q

And then my last one, just on that last point, is – any update or changes with regards to the numbers you've tried to put around your – that potential delta on deposit – on overdrafts? Thanks.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

No. The – we're doing some pilots right now on that posting order, and nothing has come to our attention that cause us to want to change that guidance we gave you of $10 million to $15 million per quarter.

Kenneth M. Usdin
Jefferies LLC
Q

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Okay. Thanks, David.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

When implemented. Yeah.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Hey, Betsy. Good morning.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Hi. Good morning. Hi. Okay, one clarification question just on NIM outlook. I just want to make sure in your second bullet point where you say, if the 10-year yield were 1.75% to 2%, that would either drive down 10 basis points to 12 basis points of NIM pressure throughout 2015. Does that scenario also include your base case scenario for the front-end moving up in the middle of the year?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

You know, we have incorporated – we our base case in terms of the front-end moving up, and then what we're trying to say is that we have – this risk wouldn't be on top of what we already project for that. So you could take our base case and then take the 10 basis points to 12 basis points on top of that.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Okay, so then if...

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

But that's – but that really is – the 10 basis points to 12 basis points, we think we'll have a relatively stable margin, like I said, in the first quarter, even at a low persistent rate environment. The impact starts to be felt later in the year, really in the third quarter and fourth quarter it gets more pervasive.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Right. So then if there's no rate hike at the front-end of the curve, does that – how does that impact your outlook? Would that be incremental negative or not that material?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, It would be, but that impact will be felt later in the year as well.

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Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Okay.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

We didn't have – we didn't really have it fully baked in until the end of the year, anyway.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Got it. Okay. And then just on the branch consolidation, the 50 branches in 2015, could you give us some color as to how extensive the review was of the branch network, and is this a beginning of consolidation or does this get you largely through what you intend to do on the network?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

So Betsy, we've been very disciplined about doing an annual review of our multi-channel delivery system, branches being part of that. When we look at investments that we're making in branches, ATMs, mobile, online, contact center, we look across the channels. We make a very rational decision on what we're investing in that. If you look at what we have done on physical branch presence, as I mentioned over the past five years to seven years, we've probably consolidated over 20% of our franchise from a branch count standpoint. We're around 1666 offices today. We will continue to look at that on an annual basis. It's an ongoing process for us. It's not a onetime and done, but it's rather part of how we think about our customer delivery points. And so, you should anticipate we'll continue to do this each and every year.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

All right. And the cost of closing the branches is in line with what you've done previously? I'm just wondering if...

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah, we have got a pretty good experience based on this, and not only from estimating the cost reductions that come out of those branches, but just as importantly is retention of customer relationships as we close those branches. And so we think from a modeling standpoint, we think we've got a pretty good model, and we understand how to execute on branch consolidations and closures.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Okay. And then, I guess just the last follow-up here is on the online product that you indicated in the prepared remarks. That in the other consumer category you should expect to accelerate in part from the online lending focus. Could you give us some color on what you mean by that, what you're investing in and how any pilots are going?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

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Yeah, I mean, the conclusion – we continue to look at both online and mobile, both of those channels having very strong growth rates year-over-year. And most of those – most of that activity, as you are well aware, is around fairly routine bank transactions, balance inquiry, funds transfer, bill payment.

But one of the things we've discovered through some of the product innovations we've had over the last two years or three years is that the desire for customers to also have the ability to borrow money online and also borrow money at point of sale.

And so we are introducing a number of new online capabilities as well as some partnership capabilities we have at point of sale. That's an activity that we'll be making announcements on as the year progresses, and just – it's just a way to extend our brand further into marketplaces that we aren't as dominant today.

Elizabeth Lynn Graseck
Morgan Stanley & Co. LLC

Q

Okay. Thanks for the color, there.

Operator: Your next question comes from Bill Carcache of Nomura Security.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Bill.

Bill Carcache
Nomura Securities International, Inc.

Q

Good morning. Thank you. I had a question on asset quality, it remains strong. But I'm trying to get a sense for how we should think about the trajectory of your net charge-off rate. It looks like it troughed at 35 basis points in the second quarter and has been rising 3 basis points to 4 basis points since per quarter. I guess, as we look ahead, should we continue to expect that kind of similar level of quarterly increase over the next few quarters as credit normalizes? I guess, at what point then does it level out, assuming credit conditions remain favorable? Any color around that would be helpful.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah. One of the things we're going to leave in our prepared comments is when you get this down to this level of charge-offs in particular, you could see volatility in any given quarter.

We're trying to leave you with a conclusion of that if you – in particular, if you look at criticizing classified loans, that's one of the earliest indicators of where your credit quality is going. That would imply that over time we see the charge-off rate continuing to come down lower. Where it settles out, we'll have to see, but we don't believe that the level it's at now is fixed. We believe that does come down. That's assuming that economic conditions continue to perform where they are now. So you have to make your own assessment as to where that terminal value would be. But it should be lower than what it is over time.

Bill Carcache
Nomura Securities International, Inc.

Q

Okay. Thank you. Separate question on auto, can you talk about the nature of your relationship with your dealer partners in the indirect auto lending side of your business, and address specifically how dealer participation

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works? In particular, I was wondering how much freedom your dealer partners have to charge auto loan customers rates that are above and beyond the rate at which you're willing to underwrite a loan.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, so we have almost 1,700 dealers today. We have a tendency to work with a large dealer groups where understanding the dynamics and the changes that are going on in the industry are in terms of pricing and trying to be fair to customers and transparent to customers.

We, like virtually everybody in the industry, do give opportunities for dealers to mark-up the rate. Today it's up to 200 basis points. We know that that's being evaluated by regulatory supervisors in the industry. And we're going to stay connected to what that looks like. We think there's a chance the whole industry might move in a given direction, but we think we're spot-on with what others are doing in the industry.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Bill, we have a very rigorous monitoring program of our dealerships to monitor their activities and to make sure that we're confident in their capabilities for underwriting and pricing. We also have a single price grid franchise-wide, and are very, very disciplined about maintaining that pricing grid in exactly where our approval rates are and at what FICO scores that we're delivering on a monthly basis. We continue to tighten up the rigor around our credit practices in that segment, making improvements literally on a continuous basis.

Bill Carcache
Nomura Securities International, Inc.

Q

Okay. Can you say, finally on that point, whether any of the changes to the practices that you've made have been prompted by your discussions with regulators? Or have kind of regulators been more kind of on a fact-finding, fact-gathering kind of mode and haven't necessarily been asking for any changes to be made just yet?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Bill, I mean, really the only thing I can say is, we continue to have very detailed and productive conversations with our regulatory supervisors. We make decisions where changes where we believe they're necessary to do in order for the business to perform better. And it's a long-standing relationship and so we feel very comfortable where we're at today. As David said earlier, there are tremendous debates in the industry about how these products are delivered. As those rules changes occur, we'll adjust to that.

Bill Carcache
Nomura Securities International, Inc.

Q

Understood. Thank you for taking my questions.

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

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Morning, John.

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John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Hi. Good morning. Good morning. On expenses, David, any ballpark numbers for what kind of savings you could get from the new branch rationalizations that you took the charge for this quarter and next quarter?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, I'll tell you that generally speaking, when we take charges, we like to target the payback period to be somewhere in the three-year to five-year range. This is on the lower-end of that. And we continue to evaluate our whole footprint and to the extent that how we can consolidate, every time we consolidate branches, we lose revenue. The idea, though, is to be able to adjust expenses, run-rate expenses faster than the revenue that we're losing. And so as we've looked at these last 50, we're closer to that three-year payback range. And as Grayson mentioned earlier, we'll continue to evaluate all of our branches and rationalize those and make investments in others.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Okay, and just to [ph] keep track (42:21) item on the operating leverage goal for positive operating leverage, I assume that's on an adjusted basis year-over-year that you're shooting for, wouldn't include like the legal charge this quarter?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

That's correct.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Okay. And is there any efficiency goal tied to that, efficiency ratio?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

We've talked about our efficiency ratio over long term to be in that 55% to 59% range. We need a rate increase for that to happen. While we wait, we believe we can drift down into the lower 60%s of efficiency ratio. 2015, we're targeting to be better than we are in 2014. And all that is on an adjusted basis.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Okay. And then just for a follow-up on the payout, how are you thinking about what's the right kind of payout ratio for Regions? You've got a lot of capital. Given how much this year's buyback was back-end loaded on a quarterly basis, you're now actually returning a high percentage of your earnings this quarter and hopefully next. I guess, just kind of as you went through CCAR, how did you approach thinking about where the payout ratio should go broadly over the next year or two?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

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Yeah. So as a result of us being in the middle of a regulatory submission, we need to be careful exactly what we're saying. We'll know the answer in – sometime in March and we'll let you know. But the way we thought about capital was, first off, we wanted to get our dividend closer to where peers and market expectations were. We clearly want to use our capital to grow our business organically. We think that's important. You look at our capital ratios that we have, we have more common equity Tier 1 than most of our peers and we believe we needed to be a little more forward-leaning in terms of putting that capital to work.

So you should expect payout ratios to be higher. We don't necessarily target a total payout ratio, per se. We look at optimizing our capital stack in terms of what's in the capital stack and the shear dollar amount to become as efficient as we can be. And we realize we had more capital, our Tier 1 common or common equity Tier 1 under Basel III than most, so that's why we think we can do the things we need to do to get the dividend up, to get the investments made to grow our business and serve our customers and return an appropriate amount to our shareholders, and that's what we did.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

And I guess one of the concerns some shareholders have is that [ph] in line to (45:00) a bank acquisition that's dilutive and you don't have a currency to your stock right now in terms of a multiple to do a bank deal. I guess, could you just give us your thoughts about being disciplined on that in terms of using capital given where you trade today and your appetite to do a bank deal opposed to doing some kind of cash deal to increase your fee income and how are you're thinking along those lines?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

You point out right. We obviously look at our currency. We think strategically about acquisitions, but I think you bring up a great point in terms of where we are from a currency standpoint. We do have capital that we can put to work in terms of the organic growth, the return to shareholders, and to use that excess capital in an appropriate acquisition, whether it be a bank or non-bank where you're using cash as the currency versus your stock. And so that's a little more available to us today given our capital position, but we are well aware of expectations on dilution and being able to pay back that dilution in a reasonable period of time.

And we're not in the mode of doing an acquisition just to do an acquisition. We're going to be very thoughtful, and we need to get our currency up. And we'll do that by executing our business plan and executing our strategy first and foremost. And there will be plenty of time for acquisitions after we get that dealt with.

John Eamon McDonald
Sanford C. Bernstein & Co. LLC

Q

Okay. Thank you.

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

Paul J. Miller
FBR Capital Markets & Co.

Q

Yes. Thank you very much. On the $10 million of increased expenses that you said related to, I guess, for outside consultants, and I guess it's related to some of the regulations, Dodd-Frank, CCAR and whatnot, is that a onetime charge, should we model that going forward into the models?

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O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Are you speaking of the $10 million for the branch consolidations?

Paul J. Miller
FBR Capital Markets & Co.

Q

No. Maybe I'm misreading, but I thought there was a $10 million for increased consultants.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

It's $5 million, Paul. If you look at outside services, it went up about $5 million.

Paul J. Miller
FBR Capital Markets & Co.

Q

I'm sorry.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

That was related to third-party consultants and our capital planning process and certain risk management initiatives. Those are areas – the reason we point that out, those are areas where – that we have a chance to cut those back and become more efficient on. But that is unrelated to the branch $10 million charge that we to ok.

Paul J. Miller
FBR Capital Markets & Co.

Q

Okay. So that's an area that you think you can get down over time, but we should be modeling that in for the short term?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, we think we can we can get that down. And third parties are one of the easiest – third-party expenditures are one of the easier ones to deal with because you don't have sign a contract. So we expect and you should expect over time that we work on third-party costs and get those down to a level that is appropriate for our institution.

Paul J. Miller
FBR Capital Markets & Co.

Q

And then, you might not have this number, if you don't, if you could have somebody give me a call back, but what – because I couldn't really calculate it. What is your capitalized cost of servicing because you take a write-down the MSR, but what did you take it down to in a capitalized cost of servicing number?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, I don't have that. We'll get – Paul, we'll get that – get back to you.

Paul J. Miller
FBR Capital Markets & Co.

Q

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If you can give me a call back, that would be great. Hey, guys, thank you very much.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Thank you.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Thank you.

Paul J. Miller
FBR Capital Markets & Co.

Q

Yeah.

Operator: Your next question comes from Eric Wasserstrom of Guggenheim.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Morning, Eric.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Hi. Good morning. I just wanted to follow-up on a couple of topic that have been addressed, but as I think about everything that you've said about your net interest margin and assuming that the forward curve is still correct in terms of implied midyear hike and given your fairly robust loan growth guidance, how should I think about sort of the geography of net interest income dollars over the next few quarters here?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, Eric, to the extent that we can get a rising rate, what we're saying is that we can have modest improvement to our overall net interest income and resulting NIM if that occurs. We do believe we'll have an increase in the shorter rates. We don't believe it will start 'til midyear. But – so we expect that to be an opportunity for us in terms of revenue growth if the loan growth will pan out like we've talked about and if the rate environment works like we've talked about, we think that's an area where we can grow revenue. We've got a pretty resilient margin relative to our peers, and so we're looking forward to that. We were trying to give you, though, if that doesn't happen, here's what the risk is relative to that expectation, and that's what the 10 basis points to 12 basis points was all about.

Eric Wasserstrom
Guggenheim Securities LLC

Q

All right. And in that scenario, does your loan growth result in flat net interest income dollars, or is there some downward risk in the lack of – in the 175 basis point to 200 basis point 10-year scenario?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

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Well, if you're adding interest earning assets, we should be able to grow with that incrementally our NII. The issue is that what – at what margin will that ultimately result in? So you could have a growing NII and a decline in the resulting margin, depending on where you put the assets on the books.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Got it. And then just to follow-up on asset quality for a moment, how should we think about your reserve adequacy at this stage, given that the reserve releases have moved not necessarily entirely with the direction of net charge-offs on a sort of quarter-over-quarter basis?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

So the question is really where we think overall allowance levels would trend. We have a pretty sophisticated allowance methodology. We get the question where do you think that will ultimately be. As charge-offs continue to come down, as criticized and classified levels come down, as non-performers come down, then you have a tendency to expect a lower allowance to loan ratio. I can't tell you where that terminal value is. I think what's going on the books today is some of the most pristine credit we've had in a long time. And I think that each quarter, as charge-offs come down, we do believe we have some leverage in our allowance, which helps us keep the provision down lower for a longer period of time. But at some point, that runs out, and you have to start providing for whatever your charge-offs are. So, the question that was asked earlier, in terms of where that charge-off may be, is something we need to look at and think through. The allowance is going to be what it's going to be, and I think there is an ability for that to come down to some degree.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah, really, when you look at the net charge-offs, you just have to keep reminding yourself there is some residual effect of credits that we filed on our books for a long time, that are getting resolved. In addition, the granularity of our loan portfolio does require some level of volatility from quarter-to-quarter on charge-offs. But when you look at the charge-off in relationship to the provision, the provision really is driving our allowance as a reflection of the overall quality of the portfolio. And as you see from the numbers, the overall quality of our loan portfolio continues to improve. We've got modest loan growth built in to our projections, but a lot of where that provision and resulting allowance winds up trending, in large part, is going to depend on the loan growth, and in what segments that loan growth occurs.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Great. And then, just last one for me. Your go-forward tax rate, what are you expecting there?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

If you right size for the impact of the legal and regulatory charge, you saw us in that roughly 29% range. And you would expect that fairly similar in 2015.

Eric Wasserstrom
Guggenheim Securities LLC

Q

All right. Thanks very much.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Matt.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Hey, guys. Just a follow-up on the energy theme. I guess, first in terms of your exposure that you laid out on page 12, which is very helpful, how do you think about how long oil prices need to stay where they are before we see some cracks, just kind of generically speaking, in your portfolio?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Matt, let me – if you would, I mean, we've prepared that in the appendix, to give you a little more data analytically on sort of our exposure. And I've got John Turner in the room with me today that manages our energy segment. So, John, if you would, if you can speak to this for a second.

John M. Turner, Jr.
Senior EVP, Head-Corporate Bank & Member-Operating Committee

A

Yeah. Happy to. In terms of how long the prices can stay down, I would say, if you look at the material we've provided, a majority of our exposure is centered either on our exploration production or our oil field services portfolios. And if we have a concentration in oil field services, it's in marine transportation companies that are serving the deepwater. We think that those companies are operating in an environment that has a much longer term to play out.

Our portfolio is comprised of relatively small number of companies. They're located in Louisiana and Texas. They're led by seasoned management teams, have really good liquidity, both in the form of cash and credit available to them. They've operated through volatile cycles before, have good access to capital. And so, we feel good about our portfolio. We've got a seasoned team of bankers and risk managers.

In terms of how long the price can stay down, I don't think we have – we don't have a sophisticated approach today to know how long that is, because we don't know where the price will end up. A lot of it has to do with where the price ultimately bottoms out, and then the length of time that it will stay there. But based upon, again, good liquidity, good experience amongst our management teams, access to different forms of capital and just a credit profile and small number of customers that we have, I'd say, we feel pretty good about our exposure today.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Okay, that's helpful. And then, just on the flip-side as I think about your consumer. From a geographic point of view, you operate in some lower income areas, and I would think some of those customers are going to benefit much more from lower gas prices, potentially, lower home energy costs. So, just talk about some of the dynamics on the consumer side, both in terms of maybe some relief on the credit, and whether there might be some boost on the lending and spending volumes as well.

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O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah, I mean, I think it's a little early to call. But clearly, the reduction in the price of a gallon of gasoline at the pump has had a material impact on disposable income of a number of our customers. And we do operate a number of markets that will really play to, as an advantage. We continue to see, from a consumer lending standpoint, consumers' credit metrics continue to improve. And we would anticipate that if oil prices, and conversely, prices at the pump stay this low for an extended period of time, that we'll see a strengthening, not only the credit of those consumers, but also the spending behaviors of those consumers.

And you see a number of different scenarios about a penny drop at the pump, and how many dollars that actually puts back into the consumer's pocket. And those numbers are just startling in size. But I would say that you – it's early to see the results of that, but clearly, it's occurring. And clearly, we'll see strengthening. I would say that in the fourth quarter, we did see really strong results in the activity of both debit and credit card transactions, both in the number of transactions, and in the dollar value of those transactions. And as you saw, a modest increase in outstanding balances in the credit card portfolio. So, maybe those are early signs, but I do think it's still a little early for us to decide what the marked improvement will be.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Okay. Thank you very much.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Marty.

Marty Lacey Mosby
Vining Sparks IBG LP

Q

Hey. Thanks for taking the questions. I wanted to ask you, David, a little bit about the prepayment speeds, if you had any impact in the security yields this quarter, maybe from the premium bonds being written down a little bit more? And then, also, you did have a big impact on the write-down in the mortgage servicing rights, does that encompass a big pickup in prepayments already? So, just wanted to see the two impacts in those two areas of prepayment speeds.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah. I think, Marty, I think those are really underrated at this point. We did see a very small amount of pickup in premium amortization. It was about $2 million that impacted us negatively in the quarter. So, I think our total premium amortization was $42 million, up from $40 million the quarter before.

Mortgage was just a little different. Obviously, we had a lot of volatility in rates. And obviously, we have had this on the hedge as much as the change in fair value as we can. We're a little less effective in those hedges, and that was part of the decline in the MSR. And then, total mortgage we had, just lower deliveries into the secondary market and we believe, a little more of a timing issue for us. So, we think those were a little more anomalies that occurred in the fourth quarter than we should hopefully see going forward.

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Marty Lacey Mosby
Vining Sparks IBG LP

Q

And would it be fair to reflect that, if you looked at the amortization, it didn't really accelerate any other future prepayments that may happen. Yet, if you look at the value on the servicing rights, may be you have accelerated some of the impact there?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Yeah, I think so. And also, we need to look at what's happening right now with rates, mortgage rates continuing to come down. We could see an opportunity for refinance activity helping our mortgage business. But also, that negatively impacts us on the mortgage servicing rights. So, we have a little bit of a built-in economic edge to some degree there. We just need to see how that plays out over the course of the year.

Marty Lacey Mosby
Vining Sparks IBG LP

Q

And just lastly, when you talked about the modest rise in interest rates, holding margins flat, pushing it up, you would still expect, if you had a short-term rise in interest rates, so that eventually kind of pull through positively on your net interest margin. So, I was – just want to make sure there weren't any structural change that was somewhat pulling that benefit down a little bit.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

No. We continue to be asset sensitive along the curve, and short-term rates, medium-term, long-term. All those benefit us. I think our last disclosure on [ph] F100 (01:02:21) was about $160 million, $170 million, which is almost split a third, a third, a third in that scenario. So, we benefit from that increase at any level.

Marty Lacey Mosby
Vining Sparks IBG LP

Q

Thanks.

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

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Good morning, Matt.

Matt H. Burnell
Wells Fargo Securities LLC

Q

Good afternoon, gentlemen. Just a couple of very quick follow-ups. It sounds from your answers to Matt O'Connor's prior questions that you have not really incorporated much in the way of increased provisions against the oil exposure that you have or the energy exposure you have in the fourth quarter provision, is that a reasonable presumption?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

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When you look at our fourth quarter provision, we're not seeing any adverse impacts yet in that part of the portfolio that would be included in the quantitative part of our allowance methodologies. In the qualitative part, obviously, any market uncertainties, oil and gas being one of those, is included in that quantitative analysis. And there would be some consideration given to the fact that oil prices have dropped, but an explicit special reserve, we did not do that. We let our methodologies process the way they are built to be modeled, and we believe we have taken the right stance on that.

Matt H. Burnell
Wells Fargo Securities LLC
Q

And just following up on that exposure, have you said publicly what the losses have been back in other periods of declining oil prices, or perhaps, what the non-performing asset levels rose to? Just to get a sense of sort of what the potential risk might be.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

We have not, but Barb Godin, our Chief Credit Officer, is with us. I'll ask Barb to make a few comments.

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee
A

We can't go back and actually reproduce those numbers at this point in time. But again, going from experience, those numbers were very small. Again, being very active in that space, as we mentioned, we've been doing this for 40 years. And so, we have gone through some ups and downs, and no, it has not impacted our books significantly.

Matt H. Burnell
Wells Fargo Securities LLC
Q

Okay. And then, just finally, David, a question on card. You sound quite optimistic about your ability to continue to drive card acceptance and card usage from your customers and the branches. Did I get the sense from your comments that you're thinking about potentially broadening the offering of those cards outside the branches, and possibly, outside your footprint?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

Our focus really has been our customer base. And the reason for that is our penetration on our customer base has been right at 16%. We expect that to be in the lower 20%s in time.

Matt H. Burnell
Wells Fargo Securities LLC
Q

Right.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee
A

And so, that's really where our focus has been. We have, from a strategy standpoint, thought about expanding outside of our customer base. And we think, right now, spending the time to, again, serve our existing customers, is probably the best route to go at this time. But it is on the drawing board for us.

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O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Well, we've made good progress. We've looked at different strategies. But again, cross-selling our current customer base continues to be our number one priority, and we've gotten better at executing on that strategy. We've had – our results continue to build momentum. We've got more active cards, more card transactions, and had more success in penetrating our book than in the past. And so, we're encouraged by our early results, and that remains our strategy.

Matt H. Burnell
Wells Fargo Securities LLC

Q

Makes sense. Thank you for the color.

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

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

Q

Good morning. Thanks for...

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Chris.

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

Q

Good morning. Thanks for taking my question. David, just a quick question, your positive operating leverage commentary, clearly implies pre-tax, pre-provision earnings growth in 2015 over 2014. But I guess, can you achieve pre-tax earnings growth, if indeed the provision expense inevitably inflects off the low level in fourth quarter?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Well, our goal is to constantly grow our earnings for a pre-tax and after-tax basis. So, we're working hard to grow all areas of revenue and control our expense base. We think net-net; we can do that from an operating leverage standpoint. But we haven't given explicit guidance as to what that pre-tax move will be. As we go through the year, we'll give you a little more clarity on that. But we're going to stick to positive operating leverage right now as the guidance.

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

Q

Okay. And then, just one follow-up. On the positive operating leverage guidance, that includes the branch closing costs in both fourth quarter of 2014 and the potential for another $15 million first quarter 2015, is that correct?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

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It includes the benefit of having that out of the expense run rate. But the actual charge, the $10 million and the $15 million are adjusted out.

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

Q

Okay.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

So, it does not include those.

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

Q

Great. Thank you very much.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

Okay.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Good morning, Vivek.

Vivek Juneja
J.P. Morgan Securities LLC

Q

Hi, thanks for taking my questions, couple of them. Oil and gas, can you just talk about your originations during the course of 2014? And also, how much do you have in commitments that went above that $3.35 billion or $3.36 billion of outstandings?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Yeah. So, to answer your second question is commitments we currently have $6.9 billion in commitments to the sector and $3.4 billion outstanding, which represents about 4.4% of the portfolio. In terms of originations, we grew the book by around $200 million year-over-year. It was fairly diverse group of originations, both in the E&P sector and in oilfield services, driven really across both states in terms of geography, and through our Regions Business Capital group, which has strong relationships with private equity sponsors in that space, and had a pretty good year in originations as well.

Vivek Juneja
J.P. Morgan Securities LLC

Q

So, would you say then, a chunk of the growth came from the private equity-related loans?

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O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

I don't have the mix exactly, but I would say that those relationships were certainly important to some of the growth that we generated through our Regions Business Capital group.

Vivek Juneja
J.P. Morgan Securities LLC

Q

Okay. Okay. Thanks. And one more question. Qualitative reserves, you mentioned earlier, Grayson. What is the amount of – what percentage of your loan loss reserves are qualitative reserves?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

We have not disclosed that, this chunk.

Vivek Juneja
J.P. Morgan Securities LLC

Q

But is that something that changed in the fourth quarter? Did it go up, down, flat? Any kind of context around that?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

A

Relatively stable.

Vivek Juneja
J.P. Morgan Securities LLC

Q

Okay. All right. Thank you.

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

Michael E. Rose
Raymond James & Associates, Inc.

Q

Hey. Good afternoon. Just two quick ones for me. What is the reserve on the loan book on the energy book today, and maybe what was it, if you know, going back to 2009, when we had a similar decline in oil prices? And then, just secondarily, what's the kind of expected impact in dollars, if you have it, around the seasonal FICO costs that you expect in the first quarter? Thanks.

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee

A

This is Barb Godin. As we look at the energy book, we don't have it split specifically that way. We do have this – we look at every account and apply, in particular, if it's a non-performing loan, we'll do a specific reserve. Other than that, we look at it in [ph] goods flown. (01:10:47) So, we don't have that comparative data to provide you. What we can say is, we feel very comfortable with what our book looks like. Again, remembering that, we do a few things. We do a sensitivity analysis on that book, we have a price deck. We do that pretty well on a quarterly basis, but the price deck, we stress it down, and then we take an additional haircut on that. We also do reserve calculations. We go 65% advance rate on our reserve calculations. And last, but not least, we also have hedging on that book. So, all

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in, we feel pretty good about that book. But again, getting back to your comments about specific reserves or reserving, we don't have numbers that we can provide you.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Michael, I'll take the second question. So, if you look at prior year, it should be relatively consistent for FICO taxes and 401k match and those kinds of things that happen in the first quarter. Those numbers are around $12 million, and then, remember that our pension cost increase of about $6 million per quarter that you'll see, that's new.

Michael E. Rose
Raymond James & Associates, Inc.
Q

Okay. That's helpful. And then, just one more back to the energy book. What percentage of your book is hedged through 2015 and then through 2016, if you have that? Thanks.

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

That's about 41% through 2015, and an additional 17%, I think, through 2016.

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee
A

That's right.

Michael E. Rose
Raymond James & Associates, Inc.
Q

Great. Thanks for taking my questions.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Good afternoon, Gerard.

Gerard S. Cassidy
RBC Capital Markets LLC
Q

Good afternoon. Hi. I apologize if you've addressed this question, I had to jump off your call. But if you look at your total energy portfolio, what percentage of that would be designated as leverage loans?

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee
A

Yeah. We currently have seven leverage loans in our energy portfolio. Five of those are managed through our Regions Business Capital group, and so it would be a modest percentage of our total exposure.

Gerard S. Cassidy
RBC Capital Markets LLC
Q

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Okay. And is there any talk, I haven't heard this, but has there been any talk amongst the OCC or the regulators to do it for the industry, and not just for you folks, of course, targeted energy credit exams this year?

Barbara I. Godin
Senior EVP, Chief Credit Officer & Member-Operating Committee **A**

We haven't heard of any, but I would believe that they probably would, just given where things are in the energy sector, we'd not be surprised. And the other comment I would also make on the leverage loans, you just asked that question, is recognizing that, the definition of leverage within the overall space, and how we define leverage is different. So, typically, as you know, leverage is defined as non-investment grade. And again, that's what banks are [ph] excited (01:13:40) to do, as we lend in the non-investment grade space.

Gerard S. Cassidy
RBC Capital Markets LLC **Q**

And then, finally, and again, I apologize if you have addressed this. Your capital, your Tier 1 common ratio is, of course, very, very strong. Do you guys get a sense that there will be at some point in the future, where the regulators will allow you to reduce that to a more manageable level, so that your return on equity can obviously go higher?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee **A**

Yeah. Gerard, this is David. There hasn't been any explicit guidance coming from regulatory supervisors on that. I think, it's incumbent upon us to ensure we have an appropriate amount of capital for the risk in our business. We clearly think we do. We think we have capital that can be more effectively deployed, and you probably weren't on the call, we talked about using that capital really for, first off, getting our dividend up to kind of a more of consistent with expectations. Using that capital to grow organically, using excess capital to the extent that there was an acquisition to pay cash for, whether it'd be a bank or non-bank. And then, returning an appropriate amount of capital to our shareholders.

We think we have the kind of capital position, and we think we have a really good understanding of the risk attended to our company, and therefore, we think over time, you'll see those drift down. Where the terminal amount is, is everybody's guess. And so, I think, we need not to get ahead of ourselves on that, but I do think capital levels do rationalize over time. The amount of time, when that is, is anybody's guess.

Gerard S. Cassidy
RBC Capital Markets LLC **Q**

I appreciate that. Thank you. And one follow-up to your comments, David. On acquisitions, not to say that you're looking at anything right now, but some of the bigger banks have commented that the BSA/AML internal reporting has been an obstacle to getting deals announced. How do you guys feel about your BSA/AML condition in terms of your systems? Obviously, MNT is still struggling to close its deal that was announced over two years ago, because of BSA/AML issues. Can you give us some color on where you guys think you stand in that arena?

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee **A**

Well, I think, ensuring that you have all of your key processes in order to participate in acquisitions is important. BSA/AML has been important to our country for a long time. It will continue to get the time and attention, and it is incumbent upon us to have all the controls in place. We invest an awful lot of time and attention in ensuring that. And we feel like we have a very robust program, relative to BSA/AML. But that doesn't mean we can't stop

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here. We have to continue to invest, and continue to be diligent in terms of those processes. But we think, we have a solid program today.

Gerard S. Cassidy
RBC Capital Markets LLC

Q

Again, thank you.

David J. Turner, Jr.
Senior EVP, Chief Financial Officer & Member-Executive Council & Operating Committee

A

You bet.

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

O. B. Grayson Hall
Chairman, President, CEO, Head-Executive Council & Member-Operating Committee

Thank you very much, we appreciate everyone's participation today, and thank you for your questions. And we'll stand adjourned.

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

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