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Regions Financial Corp. (RF)

Q2 2015 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 on line 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

Director of Investor Relations

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

O. B. Grayson Hall, Jr.

Chairman, President & Chief Executive Officer

Thank you, List, and good morning, everyone. We're pleased you could join us for today's call.

Our second quarter results reflect our continued momentum in 2015 as we reported earnings of $269 million or $0.20 per diluted share. These results demonstrate that we're successfully executing our strategic priorities. In the second quarter, we experienced increases in metrics that we believe are fundamental to future income growth, including households, checking accounts, credit card accounts and Regions 360 relationship. This growth has been broad based geographically, as all of our areas continue to expand and deepen relationships through our needs-based approach to relationship banking. Total revenue was particularly strong as both net interest income and noninterest income grew. Benefiting net interest income was loan growth of 2% and production increases of 28% and our pipelines continue to expand.

Business lending growth was achieved by all three businesses: commercial banking, corporate banking and real estate banking. Within real estate, real estate corporate banking and our REIT business growth was particularly strong. Commercial and corporate growth reflects the strength of our business model as local bankers partner with industry and product specialists, particularly in Regions' business capital, government and institutional banking, healthcare and restaurant banking to grow our loan portfolio. We also had a strong quarter in consumer lending with growth in every loan category. Of note, the home equity portfolio balances increased for the first time in more than six years. Also, new point-of-sale loan product offerings drove additional growth in consumer lending. Further, we continued to diversify noninterest income as most categories achieved growth in the second quarter, demonstrating that Regions 360 and our investments are beginning to pay off.

Adjusted noninterest revenue increased 7% from the previous quarter, reflecting growth in mortgage, capital markets and card and ATM fees, in addition to deposit-related service charges. We continued to refine our retail

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network strategy as we identified certain parcels of undeveloped land that had been purchased for future branch expansion. We no longer intend to build on these sites which resulted in additional expense in the second quarter. At the same time, our occupancy expenses declined due in part to branch consolidations executed in prior periods.

This quarter also included some legal and regulatory-related matters that impacted earnings. First, we recorded a charge related to a contingent legal and regulatory item for previously disclosed matters. And second, we received an insurance recovery related to a settlement of a previously disclosed class action lawsuit. During the quarter, asset quality was stable to improving. Net charge-offs, nonperforming loans, troubled debt restructurings all declined. The provision for loan losses increased and exceeded net charge-offs. This increase was primarily attributable to loan growth and reflects the results of the recently completed Shared National Credit exam.

We are continuing to monitor our energy portfolio and have experienced some downward risk rating migration. If oil prices remain at low levels for an extended period of time, additional migration is likely. We are, however, staying engaged with our customers and taking necessary actions as appropriate.

Before I turn it over to David, let me mention that we are extremely proud that we were the recipient of two prestigious honors this quarter. First, we were recognized by the Reputation Institute and the American Banker Magazine as having the highest reputation with our – among U.S. – our customers among U.S. banks.

And second, we were honored by Gallup as one of the best places to work. These honors provided strong evidence that our focus on building a culture based on our core values is resonating with our associates and with our customers. We're also focused on delivering strong financial results and equally important is how we obtain these results. The principle is central to fulfilling our mission of creating shared value for our customers, associates, communities and shareholders.

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

David J. Turner, Jr.

Chief Financial Officer & Senior Executive Vice President

Thank you, and good morning, everyone. I'll take you through the second quarter details and then wrap up with our expectations for the remainder of 2015.

Loan balances totaled $80 billion at the end of the second quarter, up $1.9 billion or 2% from the previous quarter. Year-to-date, loans have increased $2.8 billion or 4%. Business lending achieved solid growth as balances in this portfolio totaled $51 billion at the end of the quarter, an increase of 3%. Linked quarter production was strong, increasing 29%.

Commercial and industrial loans grew $1.7 billion, or 5%, and as Grayson noted, all three businesses within business lending experienced growth. Also, line utilization increased 97 basis points and commitments increased 3%. Consumer lending also had a strong quarter. Loans in this portfolio totaled $30 billion, an increase of 2%, and production increased 24% linked quarter. Mortgage loan balances increased $171 million and production increased 26% linked quarter.

Indirect lending for vehicles increased 2%, as production increased 12%. And other indirect lending increased $111 million linked quarter and was driven by a new partnership that focuses primarily on home improvement retailers.

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Now looking at the credit card portfolio, balances increased 3% from the previous quarter and our penetration rate now stands at 16.4%, an increase of 80 basis points from last year. And finally, total home equity balances increased $45 million from the previous quarter as new production outpaced portfolio runoff in the second quarter.

Let's take a look at deposits. Supported by our multi-channel platform, average deposit balances totaled $97 billion, an increase of $1.3 billion during the second quarter. Deposit costs remained near historical low levels at 11 basis points, while total funding costs were 25 basis points in the quarter. And let's look how this impacted our results. Net interest income on a fully taxable basis was $839 million, an increase of 1% from the previous quarter. Driving this increase was an additional day in the quarter, higher loan balances and a decrease in the cost of wholesale borrowings. This was partially offset by the continued low rate environment and modest compression of spreads in the loan book.

The net interest margin was primarily affected by pressure on asset yields, resulting in a two basis point margin decline to 3.16%.

Total noninterest income increased $120 million, which included $90 million related to insurance proceeds received in the second quarter related to a previously disclosed matter we accrued for in the fourth quarter of 2014, and this matter settled during the second quarter. Excluding this item, adjusted noninterest income was robust, increasing 7%, reflecting our investment in and commitment to diversify and growing fee-based revenues.

Mortgage had a solid quarter as income increased 15%. Loan production volume and market valuation of mortgage servicing rights also improved.

Capital markets was a significant contributor, with a $7 million quarter-over-quarter increase in fees. This was primarily related to the placement of permanent financing for real estate customers, an increase in broker-dealer revenues associated with corporate fixed income underwriting and the successful completion of our first M&A advisory engagement.

Card and ATM fees increased 6% as a result of increased debit and credit card usage as customer spending increased 7% and transactions increased 9% over the prior quarter.

Commercial credit fee income increased from the previous quarter due to a reclassification from net interest income. This lowered net interest income by $3 million. And the future run rate of commercial credit fee income should be approximately $20 million. And finally, service charges increased 4%.

Now let's move on to expenses. Total reported expenses in the second quarter were $934 million, which included two charges totaling $75 million. First, as Grayson mentioned, we transferred some properties originally purchased for future branch sites to held-for-sale and incurred a $27 million write-down. Second, professional and legal expenses totaled $71 million; however, this included a $48 million net accrual for contingent legal and regulatory items for previously disclosed matters. Importantly, based on current information, we expect the estimate of reasonably possible contingent losses to decrease by a significant amount.

Salaries and benefits increased 4% from the previous quarter. Annual merit increases impacted expenses along with an increase in incentive compensation. This increase is partially due to unusually low incentives in the first quarter, as well as additional incentives tied to revenue growth.

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Outside services increased $9 million partially related to fees paid in connection to revenue generation as well as increases in other costs associated with risk management activities. However, due to the nature of these expenses, we believe there are opportunities for improvement going forward.

Deposit administrative fees declined from the first quarter primarily due to refunds from prior periods, and the expected run rate for this line item is in the low $20 million range.

Our adjusted efficiency ratio was 64.5% in the quarter, an improvement of 40 basis points from the prior period as we continue to make investments in talent and technology for future revenue growth and long-term efficiencies. Our effective tax rate for the second quarter was 30.1%, which included a benefit of $7 million related to the conclusion of state and federal tax examinations. Excluding this benefit, our income tax rate would have been 31.8%.

Now moving on to asset quality, total net charge-offs declined $8 million and represented 23 basis points of average loans, an improvement of five basis points. The provision for loan losses was $63 million, exceeding net charge-offs by $17 million. As Grayson mentioned, this increase was primarily attributable to loan growth and reflects the results of the recently completed Shared National Credit exam. Our allowance for loan losses was 1.39% at the end of the second quarter, down one basis point from the end of the first quarter.

Total commercial and investor real estate criticized and classified loans increased $126 million or 5% from the prior quarter. However, they remained relatively flat as a percentage of total loans. The increase was driven by some weakening in large-dollar commercial and industrial loans within the energy and other portfolios. Compared to the prior quarter, troubled debt restructurings, or TDRs, declined 7%, and our nonperforming loans decreased 6% linked quarter. And at quarter end, our loan loss allowance to nonperforming loans or coverage ratio was 149%. And given where we are in the credit cycle, the large-dollar commercial credits in our portfolio and fluctuating commodity prices, volatility in certain credit metrics can be expected.

Let's move on to capital and liquidity. During the quarter, we repurchased $172 million or 17 million shares of common stock and declared dividends of $80 million. During the quarter, we returned 94% of earnings back to shareholders. And under the Basel III provisions, we maintained industry-leading capital levels, as the Tier 1 ratio was estimated at 12% and common equity Tier 1 was estimated at 11.2%. On a fully phased-in basis, common equity Tier 1 was estimated at 11%.

Liquidity at both the bank and holding company remained solid with a low loan to deposit ratio of 83%. And regarding the liquidity coverage ratio, Regions remains well-positioned to be fully compliant with the January 2016 implementation deadline. It is important to note that no major balance sheet initiatives are expected in order for us to be compliant.

So, let me give you a brief review of the expectations for the remainder of 2015. We continue to expect total loan growth in the 4% to 6% range on a point-to-point basis. However, if current momentum continues, we should skew towards the higher end of that range.

Regarding deposits, we continue to expect full-year average deposit growth in the 1% to 2% range. And with respect to margin, our expectations for the year are essentially unchanged and we look for margin to remain relatively stable over the balance of 2015. However, we anticipate net interest income growth under our baseline expectations for loan growth and an increase in interest rates later in the year.

Finally, we expect to continue to benefit from revenue initiatives, while, at the same time, prudently managing our expenses. And we remain committed to generating positive operating leverage over time. The second quarter was

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evidence of our continued momentum in 2015, and we remain focused on executing our financial priorities of diversifying revenue, generating positive operating leverage and effectively deploying our capital.

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

M. List Underwood
Director of Investor Relations

Thank you, David. Excuse me; 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 like to ask each caller to please limit yourself to one primary question and one related follow-up question.

Now, let's open up the line for questions, operator.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of John Pancari of Evercore ISI.

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

A

Morning, John.

John Pancari
Evercore Group LLC

Q

Morning. Question on the margin again, David, thanks for the guidance there. For your expectation for relatively stable, just how would you define that? Is that give or take a couple basis points? And, if so, is it fair to assume, just given this rate environment, that we continue to see some modest degradation, maybe a couple bps a quarter or so until we get the Fed really moving?

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

A

So, John, you're right, we've tried to maintain the definition of relatively stable throughout this last year or so as one to two points either side of where we are right now. And so, when we say that, that's what we're looking for for the remainder of the year. Obviously, if we get rates turning on us a little bit and we have the loan growth, you know, send the message on the NII growth that we expect to have and, you know, we should see margin move in that direction. But right now, our call is relatively stable for the remainder of the year.

John Pancari
Evercore Group LLC

Q

Okay, all right. And then separately, on the expense side, I know you had initially given some efficiency ratio expectations, and you were talking about the low 60%s by the end of 2015 and wondering how you feel about that at this point and then also high 50%s or so in 2016 and wondering if that is still something that you view as achievable.

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

A

Yeah, we've continued to target being in the lower 60%s. To get into the 50%s, we do need to have a rate increase for that. Clearly, we need two things to happen: revenue increases and continued focus on expense management to get our efficiency ratio down. We had a 40 basis point improvement in the quarter. And I think with our internal focus on expense management and continuing to make investments in the right areas to grow our revenues, things are working out. We're moving in that direction. So, to get into the lower 60%s will require us to continue on this path that we're on right now.

John Pancari
Evercore Group LLC

Q

Okay. And on that, the low 60%s, you don't need higher rate, any kind of rate hike to get to that, though?

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

A

Like I said, we have forecasted to have a rate increase this year, and that is in our discussion and conclusion on improvement from here of our efficiency ratio.

John Pancari
Evercore Group LLC

Q

Okay. All right. Thanks, David.

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

Stephen Kendall Scouten
Sandler O'Neill & Partners LP

Q

Yeah, Hi. Thanks, guys. I was wondering if you could give some more color around your existing SNC portfolio, what the overall size of that portfolio is and kind of what concerns you might have coming off that SNC exam.

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

A

If you will, I'll ask Barb Godin, our Chief Credit Officer, to make a few comments on that and John Turner, our Head of Corporate Banking Group, the two of them can provide color on that.

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

The overall size of our outstanding SNC portfolio is roughly in the $16 billion range, but as it relates to the results of the SNC exam itself, that cannot be disclosed, that is confidential supervisory information, so I would not say much more about that, but we're comfortable with the book in terms of the credit quality that we see in that book. It's very well rated. I'll turn it over to John Turner to make a few more comments.

John M. Turner, Jr.
Senior Executive Vice President, Head-Corporate Banking Group

A

Just in general terms, the SNC book represents a little less than 45% of our total commitments within the Corporate Banking Group. We do think it's an important part of our business. It's a business that we have grown

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some clearly over the last two years or three years and it's a business we think that will provide us significant noninterest revenue opportunities. As we talk about a shifting of mix of revenue within the company, one of our key focuses is to grow our corporate bank and to grow our capabilities to serve those customers that we're now interacting with in a more significant level as part of the Shared National Credit portfolio. So we view it as being very strategic and giving us an opportunity to grow significant relationships with customers who can drive NIR.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP
Q

Okay. And then maybe one other question here just in regards to other opportunities for capital deployment. What are you guys thinking about from an M&A perspective at this point in time? Are there any increased conversations or increased desire on you all's part to get something done in that regard, especially given BB&T – the approval of their Susquehanna deal, does that give you greater level of confidence or move up the timeline for potential M&A for you guys?

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

I think that first and foremost, we're focused on organic growth, focused on executing our business strategies and trying to build a better bank and have a better team. We are closely monitoring all M&A activity. We are preparing ourselves in the eventuality that opportunities present themselves. We think that some of the activities in the M&A space of late have been constructive. We think that's helpful as we sort of prepare our long-term strategies. That being said, at this juncture, our efforts are predominantly around preparation, if opportunities present themselves, but our primary focus is growing organically.

Stephen Kendall Scouten
Sandler O'Neill & Partners LP
Q

Okay, thanks, guys. Appreciate taking my questions.

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

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

Good morning, Eric.

Eric Wasserstrom
Guggenheim Securities LLC
Q

Thanks very much. Hi, good morning. Just a couple of questions on credit quality. You were very clear on the dynamics about what led to this quarter's provision. But as I look at the relationship of the reserve to loans, it seems to be stabilizing at around the 1.4% level, whereas some peers have continued to take it down closer to 1.25%, and I'm just wondering what you sort of view as adequate going forward if there isn't any incremental migration in the SNC portfolio.

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

So, this is David. We don't have any particular percentage that we aim for. We let the model run. There is obviously some judgment at the end of the day, but a lot of it is model-driven. When you have 23 basis points worth of charge-offs, and that can continue, if that continues, over time, you should see a migration down to some

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point. I will tell you that we – the loan growth we've had have been larger commercial credits. We tried to give you some color on the volatility that you can expect when you have larger credits and one of them trends negatively. We have – we feel good about the reserve. We feel good about our overall credit quality and trends and their non-performers coming down. And – but we also have loan growth that we have to provide for. When you mix all that together, if we can continue to see a reduction in non-performers and a reduction in charge-offs, you would expect the coverage to come down, but we need to see that on a quarter-by-quarter basis and let our model run.

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

A

No, it's got to be – we're committed to a very data-driven process, and we're letting the data drive that number. As David said, we're not targeting a particular ratio, but instead, we're targeting a process where we evaluate the credit quality of our portfolio and let the data drive that decision.

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

However, I don't think it will go back to the old days, as we call them, of 1%. There will be a new floor established at some point, but it will not go back, we don't believe, to those pre-recession levels.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Great. Thanks, that's very clear. And just one quick follow-up. Obviously an outstanding quarter on the brokerage and investment banking line item. How do you suggest we think about sort of the sustainable run rate of revenues in those business lines going forward?

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

A

Well, it was really, I think in a lot of ways, a very important quarter for us. We really saw growth across – more broadly across our markets and more broadly across products. We've been making a number of investments in parts of our business that grow noninterest revenue. We've really started to see the traction that those businesses are able to gain in this market. We believe that their contributions will continue to increase. And when you look at the growth across the company, it's very encouraging, just starting to be reflected into the numbers, but very promising as we look forward. And David, do you want to comment a little more on it?

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

A

Yeah, we were encouraged with, as Grayson mentioned, we made investments in people. We got our first M&A transaction; we're looking to grow in that space. We've made – invested in the Fannie Mae DUS license, not quite a year ago, that's paying off for us. So, these investments that we've made, we feel good about the continued improvement. There was nothing in revenue that causes us to believe there's a – was a one-time issue there in terms of favorability that won't repeat. We are looking to continue to grow that, the pace of which depends on the business that we can execute. So we are very encouraged by that NIR growth and how broad it was.

Eric Wasserstrom
Guggenheim Securities LLC

Q

Great, thanks very much.

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

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

A

Good morning, Matt.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Good morning. Can you guys provide the premium amortization within the bond book this quarter and maybe how that compares to previous periods?

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

A

Yeah. So we're at $41 million this past quarter, Matt. It was about $2 million different than the previous quarter.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

$2 million lower, I would assume?

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

A

That's right.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Okay. And then just, I mean, looking forward, does that drop more significantly if the backup in rates hold here?

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

A

You know, I think we're showing a relatively stable, kind of a moderation of that premium amortization from here.

Matthew Derek O'Connor
Deutsche Bank Securities, Inc.

Q

Okay. And just, I mean, in terms of why that would be, is it just – there's some banks out there where it's really sensitive quarter-to-quarter and I think yours incorporates both, you know, the rate outlook and the actual prepayment. So, is it just little bit of a smoother impact than maybe some other banks?

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

A

Yeah, I think others can have a different method of amortization. Ours are fairly, should be fairly resilient, like I said, from here. We used to have – our premium amortization was a much bigger impact to us, but our total premium that exists in the book is down. We also have more 15-year products, so it's a little less impactful to us than perhaps some others.

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

Okay. And then just separately, the deposit service charges, obviously, nice bounce linked quarter there probably on seasonality. But as we think about you implementing some of the changes you talked about, I think it's the high-to-low and some other, just provide an update on that, the magnitude and the timing, and if there's been any change versus what you'd thought maybe six months ago.

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

Yeah. So our service charges, that was seasonality that you saw. If you compare year-over-year, the main difference between – the prior year had already advanced product in there, and as you know, we're out of that product now. We have continued to investigate changing of our posting order. We still are committed to that effect on us when we implement it to be in that $10 million to $15 million range. We expect to implement that towards the latter part of the year, so we haven't changed our timing from our last call, but you should see that go in the latter part of this year, so there will be some impact in 2015.

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

You know, additionally, Matt, we've seen steady growth in consumer checking account since the 1st of the year. And so, as we continue to grow accounts, then that gives us an opportunity to continue to grow that line item, so pretty encouraging news in that regard.

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

Okay, thank you very much, thanks for taking my questions.

Operator: Your next question comes from the line of Sameer Gokhale of Janney Montgomery Scott.

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

Good morning, Sameer.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC
Q

Hi, good morning, thanks for taking my questions. Just on the last question you got, the follow-up on that, to clarify, I think that you have switched or are switching to a chronological format for posting order. Is that right or are you doing high-to-low? I thought – I just want to clarify that.

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

Chronological.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC
Q

Okay.

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

A

To the extent possible. I think chronological in the purest sense is not possible, but chronological to the degree the transactions allow us to do that.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC

Q

Yeah, no, I understand. There seems to be a lot of complexity and lack of clarity around exactly what the final rules will be. But just to kind of further flesh that out, I was curious as to your adoption of the chronological order because in talking to other banks, it seems like many of them have not yet done anything, they're waiting for the final rules to come out. And if and when – when the final rules come out, if they're different from what you've kind of implemented, then wouldn't you need to change that again, so I was just trying to get a sense for the thought process there and kind of going ahead with the chronological process, the chronological order.

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

A

Yes, Sameer. I mean as we think through it, we're absolutely focused on trying to serve our customers in the way that we believe to be appropriate. And we think that there's a growing perception on the part of customers that some type of chronological-based posting is a more appropriate way to go. We are in close communication with our regulatory authorities about thoughts on process and thoughts on posting and we appreciate that that may change on [indiscernible] (32:59) believe we're building the process, but we're – almost all of our transactions will be time order posted.

That being said, because of the complexity of posting, you never quite get the perfection. But we believe it's the right thing to do and so we're pressing ahead with it. As David said, right now, our project plans would have us completing that this year, and so we're on schedule to do that. And if changes occur in subsequent quarters, we'll make changes as they're deemed necessary and appropriate. But I think we waited long enough. And we feel like that it's the right time from a – purely from a customer standpoint that we need to do this. It's got – obviously any change can have a mixed reaction on the part of the customers and we just want to be careful that our customers – we communicate well and we're transparent and we do this – not only do the right thing but do it the right way, and so we're trying to do that.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC

Q

Okay. And then just a quick one, if I may, I know you talk about the home equity loans growing for the first time in a long time. I don't know if you had mentioned what the reason for that is, and if you could give us a sense for what those proceeds are being used for, are they being used to pay down consumer credit cards or something else, that would be helpful? Thank you.

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

A

Well, I mean we've been – we – a few years ago, we were predominately an equity line of credit is the product that we went to market with. I think that as you saw quite a while back, we introduced a – amortizing home equity loan that has proved very attractive to our customer base. What we've seen is, in this quarter, when you consolidate the net of home equity lines and home equity loans, you've seen customers that – you've seen that pivot point where on net basis, for the first time in six years, we have started to grow that portfolio. That's the combination of the

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runoff of the equity line portfolio has slowed and the increase in the home equity loan has increased substantially to accommodate that.

I would say anecdotally, most of the home equity loans we're making are for sort of smaller-dollar home refinance. Also, home repairs, and to a less degree, and last on that list would be debt consolidation. Strong FICO score probably averaging close to 7 – 778, LTV of around 60%, so good product going on, and I think serving our customers well.

Sameer Shripad Gokhale
Janney Montgomery Scott LLC

Q

That's great. Thanks, Grayson.

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

Erika P. Najarian
Bank of America Merrill Lynch

Q

Hi, good morning.

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

A

Morning.

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

A

Morning.

Erika P. Najarian
Bank of America Merrill Lynch

Q

Morning. I just had one follow-up question on credit. Barb, it looks like the way I'm reading the charge-off breakdown in C&I this quarter and in owner-occupied CRE last quarter, the single basis point loss rate implies to me that there could be recoveries in those two categories. And I guess the question here is, as we think about provisioning and reserving going forward, is a 23 to 28 basis point charge-off range that we saw in the past two quarters sustainable? Or given potentially outsize recovery, should we look to the range prior to those two quarters of between 35 to 40 basis points?

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

Yeah, Erika, recoveries actually did play a role in what we saw this past quarter, but it also played a role in prior quarters. And so, one thing I would caution on as I think of recoveries is a lot of the loans that we've charged off, those are the recoveries that we've already received as our charge-offs have come down [ph] as well as (37:21) opportunity for recoveries going forward. The 23 basis points of loss that we're pretty pleased about this quarter is great, but we do believe, again, that that's probably close to, you know, at the bottom of where we're going to be. We might get another point or two out of it. But, again, we'll probably move somewhere between that 25 to 35 basis point range as we think forward.

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Erika P. Najarian
Bank of America Merrill Lynch

Q

And the second question to that is how long do you think, from a credit standpoint, we could stay in that 25 to 35 basis point range? And I guess a better way to ask that is, do you see anything near-term that could move you outside of that band?

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

Yeah, the only thing I can see near term at all is something that we can't see. You know, from everything that we see that's in front of us, we feel comfortable that we'll stay in that band. But, again, you never know if you have some other factor that happens in the economy that will create an issue for us and we'll disclose it at that time.

Erika P. Najarian
Bank of America Merrill Lynch

Q

Got it. That's helpful. Thank you.

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

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

A

Good morning, Ken.

Kenneth Michael Usdin
Jefferies LLC

Q

Thanks, good morning, Grayson. I was wondering if I could ask a question on expenses in an absolute sense. So, David, you talked about having a little room in some areas to improve, but then you talked about also the kind of normalization of that deposit administrative line. So what are the puts and takes in future expense growth and how much of that continued investment burden do you still bear from here?

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

A

Well, I wouldn't categorize investment as a burden. Some of that is good. The investments we're making to grow our revenue generators is a good expense. We'll do that all day long and expect a return for those type investments. I will tell you, though, as we think about managing our expense base, again, we've got to look at salaries and benefits, occupancy, furniture and fixtures and our outside services, so those four categories. And in that, we can tighten up a little bit in terms of some of the investments we've had to make over time to deal with the regulatory environment that we're facing in just the banking industry, things that are related to risk management, capital planning and those kinds of things that – and compliance and audit, all those over time will rationalize. And you should see some opportunities for us there.

Also, as you know, we've done branch consolidations in the past, and that's brought down salaries and benefits. It's brought down furniture and fixtures. It's brought down occupancy expense. And while we don't have any current plans for branch consolidations, we're continuing to look at our branch footprint as part of our retail network strategy to ensure that channel is optimized, that we will make investments where appropriate and we'll tighten up other areas that – or other branches where the revenue generation isn't strong enough for us.

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And then lastly, I'll tell you we have a number of Six Sigma initiatives underway in our company. Virtually every department has an obligation to look at how they can become more efficient. We haven't had a named expense initiative, as you know. But internally, we have an intense focus on expense management. And so, there is not an expense that is off the radar screen, but the areas where we'll move the meter are those four or five areas I mentioned.

Kenneth Michael Usdin
Jefferies LLC

Q

And, you know – oh, sorry, go ahead, Grayson.

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

A

No, I'd just add to what David said. I think we're absolutely committed to rigorous expense management across the company. You can never be as good as you want to be in that regard. We continue to challenge ourselves internally, that are we being good expense managers? In this environment, it's a critical skill. But we also are more than willing to make prudent investments that allow us to grow prudently. And so, we will continue to do that. We think those have been smart decisions. They certainly are paying off.

And to David's point, we'll do that every day. And we've done that in terms of recruiting new bankers onto our team, making investments in our current team to allow us to grow more appropriately, but prudently, and so it's part of – if you look at – and if you back up and look at our efficiency ratio and you look at it both expense and revenue side, we've done much better on the expense side than we have on the revenue side. And we're trying to take a very balanced approach to expense management, a thoughtful approach that gets us where we want to be. And to David's point, we're trying to make incremental improvement every quarter to get down to that lower 60% efficiency ratio, but it's going to require work on both sides of that formula.

Kenneth Michael Usdin
Jefferies LLC

Q

Yep, understood. And just as a quick follow-up on that, working on it and is it the type of stuff that – I know you don't have a program or a number, but as you think about the things you can work on, is it more just about monitoring the rate of growth, or do you think you have the ability to actually at some point get the expense base back down?

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

A

Well, let me – it's a – not to make it more complicated than it is, we clearly have been making investments in risk management, and we've been making investments in bankers, in growth opportunities that we see. We try to self-fund a great deal of that expense, and have, by process improvement in a number of our back offices. We've tried to do that process improvement in a lot of our support offices, such as legal, and in vendor management. But we also have tried to rationalize our channels, and, in particular, the branch channel has been, we think, pretty aggressive in rationalizing channels and trying to make them as efficient as we can without reducing our effectiveness for the customer. And so, while we don't have a branded program, rest assured, we've got lots of internal programs.

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

A

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And Ken, we were down in expenses four years in a row. We didn't commit to having expenses in 2015 lower than 2014 because we knew we wanted to make investments in the revenue generators, and some are still coming onboard, so they haven't generated the revenue. We think that's the right kind of spend for us. Can we get down to the expense level that we had in 2014 at some point? It just depends on the investments we make going forward. I think the first order of business is to watch the spend so that the rate of growth is the most appropriate rate of growth, and then we can look at how efficient can we get over time with the use of things like Six Sigma and so forth.

Kenneth Michael Usdin
Jefferies LLC
Q

Understood. Thank you.

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

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

Good morning, Geoffrey.

Geoffrey Elliott
Autonomous Research LLP
Q

Good morning. How are you?

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

...well.

Geoffrey Elliott
Autonomous Research LLP
Q

A question on the energy portfolio. I was interested to see that was kind of down a couple of percent over the quarter, which is lower than the pace of decline that we've seen at some of the other banks. So, I'm curious, is that a deliberate strategy on your part? Are you trying to pursue more of a stick with the customer, keep providing credit strategy than you think some of the other banks might be? Or do you think that that could just be differences in structure of portfolios?

John M. Turner, Jr.
Senior Executive Vice President, Head-Corporate Banking Group
A

Geoffrey, this is John Turner. First of all, let me say we're committed to sticking with our customers where that makes sense, and I think as we think about what we are doing today, we're approaching our valuation business on an ongoing basis with a healthy skepticism, but staying very close to our customers so that we understand what's going on in their businesses.

When you look at the reduction in commitments primarily occurred in the E&P space, where, as a result of borrowing base redeterminations, we reduced commitments by a little over $320 million, or on average about 16%. We also had a number of our customers access the capital markets, and, in fact, over the last seven months, I guess, it raised over $7 billion in the capital markets. They've used those funds to – both to add additional liquidity, to potentially make investments to reduce their leverage, and so that certainly had an impact as well.

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And we think our clients are doing all the right things. And so as a result, we have a – we're cautiously confident about the performance of the book. When I say doing the right things, our customers have reacted quickly to market conditions, they've reduced their expenses, reduced their CapEx, they are raising liquidity and reducing leverage where appropriate, and as a consequence, I think we'll continue to see some reduction in the business until the market turns and reinvestment occurs.

Geoffrey Elliott — Q
Autonomous Research LLP

And...

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

And John, if you would speak for a minute about customer selectivity and limited number of names in our book?

John M. Turner, Jr. — A
Senior Executive Vice President, Head-Corporate Banking Group

Yeah, I think just another aspect of the way we think about the risk in the book is, I've said this before, we have really a small number of larger names. We think client selectivity has been one of the hallmarks of our energy book. These are customers that we have known for a long time, most of them, at least of any size, are very recognizable in the industry. Management teams are very experienced. As I mentioned, good access to capital markets and liquidity and we think that they're doing all the right things.

We spend a lot of time internally reviewing the portfolio. I mentioned that we have a quarterly review process for our oil field services book. We've now looked at internally over 91% of our oil field services exposure within the last four months. We also have done borrowing base redeterminations on all but one of our E&P relationships, so 98% plus or minus of that book. And then our energy portfolio has been subject to a number of external reviews including the SNC exam where we think 67% of our total energy book was reviewed as part of the SNC exam, that's about 89% of the E&P portfolio and over 55% or about 55% of oil field services. So, a lot of eyes on our energy portfolio. We think a lot of transparency given the fact that there are a smaller number of larger exposures, which is a good thing. On the down side, there is some single name risk associated with deterioration. But all in all, I think we feel like we have a pretty good handle on the exposure in the energy portfolio.

Geoffrey Elliott — Q
Autonomous Research LLP

And to follow up, the increase in indirect exposure, what happened there over the quarter?

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

We had some – yeah, we had some reclassifications as we continue to look for indirect exposures that are in some way impacted by the energy business. So, as an example, we pulled in some of our investor real estate portfolio where we have income-producing properties that are leased to third parties which happen to be in the energy space. And so as we captured that as an indirect exposure, that had an impact on outstandings, as an example.

Geoffrey Elliott — Q
Autonomous Research LLP

Thank you.

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

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

A

Hello, Matt. Good morning.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Good morning. Thanks for taking my questions. David, maybe a question for you. You mentioned branch – the branch reduction, and obviously that's been a positive story for you all, down about 3% year-over-year with somewhat more positive momentum in the last couple of quarters, but also looking at the transaction services only line, that's been pretty stable. I guess I'm curious how you all are thinking about the product delivery capability over the next couple of years as you think about rationalizing branches, full-service branches. Should we begin to see the full-service branches continue to come down, but at the same time, the transaction services presumably smaller and less costly branches rise?

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

A

Well, you asked the question to David, but if you don't mind, I'll answer it. You know, I think that as we've said about a number of our businesses around the company, we tend to be very data-driven. And we think it's important to make sure we understand the data and what's going on in all of our channels and branches in particular. We're doing a lot from an experimentation and an innovation perspective with new branch formats, less people, more technology. We also are experimenting with a number of innovative designs around drive-throughs and our capabilities, our ATMs and offsite locations.

All that being said, we still, when you look at the markets we operate in and the customers that we serve, and we serve almost 4 million customers across 16 states, they all have different needs. And when you look at our customer base, still 59% of our customers will visit one of our branches in the next 30 days. So we still have a lot of customer traffic, in fact, we've got a lot of branches that are operating at overcapacity levels. And so we've introduced a number of digital capabilities. Deposit, smartphone deposit capture, remote deposit capture for our small business and corporate customers. We try to use innovation to try to take more transactions out of our branches that allows us to be more efficient, but also dedicate more resource to sales and service.

And so, we've been introducing technology under ATMs. Roughly 75% of our ATMs today have the ability to take a deposit through image technology. If you look at how efficient we've got, almost 21% of the deposits in our company are coming through a digital channel as opposed to coming through one of our branch offices. So making good progress, but we're letting the data drive the number. So when we see a branch that is – that transaction volumes and customer accounts in a particular branch is-drives that decision, so that we don't do that anecdotally, but we do it with a lot of data and data analytics, and so we'll continue to do that. I do think customers are showing a preference for additional channels, but it varies by market. And a lot of our markets are still very, very branch-dependent, and so we pay attention to that.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Okay, that's helpful color. And, David, maybe I can direct this one to you specifically on the earning assets. You saw about an $860 million decline, 29% decline, in other interest-earning assets, which I presume is mostly cash at the Fed. How does that number trend in your current outlook for margin through the rest of the year?

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

A

Yes, you're exactly right. So we put the excess cash to work so that that pushed in terms of the loan growth. We should see some growth in earning assets that will come with deposit growth picking up. And the question is, where will that be deployed in the securities book, cash at the Fed or in loan growth. And we feel good about our loan growth. We gave you a little bit of guidance in terms of what we thought we would do, skewing towards the upper end of our previously announced range, so...

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Right.

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

A

We expect that to pick up slightly.

Matthew Hart Burnell
Wells Fargo Securities LLC

Q

Thank you.

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

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

A

Good morning, Gerard.

Gerard S. Cassidy
RBC Capital Markets LLC

Q

Good morning. Thank you. Couple questions. One, could you guys just go over the Shared National Credit outstandings, I didn't hear it clearly and I think the transcript may have gotten the number incorrect.

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

A

Barb, if you could speak to that.

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

Yes, I'll speak to it. In fact, it's $18 billion roughly in outstandings that we have for the Shared National Credit.

Gerard S. Cassidy
RBC Capital Markets LLC

Q

Okay, because the transcript I think said $50 billion. I assume the transport's incorrect, then.

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Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

Yeah, you are correct.

Gerard S. Cassidy
RBC Capital Markets LLC

Q

Okay. Thank you for classifying that. Coming back to your loan portfolio, at one point, you guys were de-risking the portfolio by allowing the commercial real estate balances to come down. And I believe that ended some time ago, but they're still shrinking. And maybe can you give us some color what's going on in the commercial real estate investor as well as owner-occupied commercial real estate mortgage portfolios?

John M. Turner, Jr.
Senior Executive Vice President, Head-Corporate Banking Group

A

Yes, this is John Turner. First, let me start with owner-occupied real estate. We're continuing to see that book run off a bit. And I think that's as much reflective of the fact that we're just not seeing middle market or the lower end of the middle market and our business banking, small business customers, invest in expanding their businesses. So the volume of activity that we see is down, that portfolio amortizes every month and so we're continuing to see some runoff, although the runoff is slowing a bit and we expect that trend to actually turn in the future.

As it relates to investor real estate, we did derisk the book. We have remade our business model, built it around professional real estate bankers, working closely with real estate developers who've been, again, real focused on client selectivity. It's a business we want to grow, but it's heavily construction-oriented today. And we'd like to see it shift more to have a better balance between construction and term lending. We are very committed to managing that book in a very disciplined and thoughtful way, applying our concentration limit methodology to make sure that we don't have too much exposure to any product type or in any particular market. Diversity is really important to us as we think about managing that business going forward. So I think you can expect to see it grow sort of as the economy grows would be our plan, kind of in the 2% to 4% range, but not much faster than that as we seek to manage that risk prudently and shift again the mix from construction to more term-oriented.

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

A

Thank you, John.

Gerard S. Cassidy
RBC Capital Markets LLC

Q

Great. And then just as the follow-up. Grayson, you gave us some good color on the branches and your digital channel and the activity you're getting through the digital channel, and it's certainly a topic of debate in the industry today about the retail branch model. With your 1500 or so branches, can you guys give us some color on the profitability? How many of those are meeting your return on equity or internal rate of return hurdles, how many are not profitable, to give us a flavor?

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

A

Yeah, I mean, we've certainly, we calculate that data, we calculate that data on a real frequent basis, and we've got different hurdles that we try to monitor to make sure each of our offices are meeting our hurdles. And where we're at today is roughly 98%, 99% of our branch offices are providing a positive direct contribution to our earnings.

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That being said, do they all hurdle over internal rate of return requirements for branches or we have to look at each individual branch and see whether that branch is predominantly servicing transactions, or are they growing accounts, are they growing balances, both deposits and loans, and we take all that into consideration and we take in consideration the markets they operate in before we make that consolidation decision.

Quite frankly, we are seeing tremendous growth in digital channels, but the growth in digital channels is faster than the reduction of activity in our branches. A lot of digital activity is new activity, that's additional activity. But we are seeing patterns in our branches change and we make movements, take decisions based off those behavioral changes. But I'll go back to my earlier comment. When it comes to the branch, our decision can't be anecdotal, it has to be based off the absolute numerics of that branch and it has to be in the best interests of the community that we operate in. Our engagement in our communities and our commitment to the communities we operate in is very, very important to us, and so all of that has to be considered when we look at branches.

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

Gerard, I'll add to that that, one thing we have consolidated a little over 20% of our branch accounts since the crisis. We stay focused on it. And one of the things we need to – we have to think through is even those that don't give us the return we would like, is we have to look at what the next alternative is if we don't have that branch. Because anytime we consolidate a branch, we lose revenue. Now, the goal is to lose more expense than the revenue that we just lost. And that's why you've seen the consolidation being a very measured pace. We will continue to look at that. And while we don't have any identified as of right now, you should expect us to continue to rationalize our whole retail footprint over time.

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

But I think an important point to make is that today, we're seeing a higher level of sales growth in our physical points of presence. In fact, our branches, our sales in the second quarter, new account sales in the second quarter, is the highest we've seen in four years, so very good performance out of branches this quarter.

Gerard S. Cassidy
RBC Capital Markets LLC
Q

Grayson, David, thank you.

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

Thank you.

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

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

Good morning.

Vivek Juneja
JPMorgan Securities LLC
Q

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Hi, thanks for taking my questions. A couple of questions, firstly, Barb, on your Shared National Credits of $18 billion, how much are you the lead on?

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

We are the lead on, I don't have the dollars at my fingertips, but it is roughly 100 credits.

Vivek Juneja
JPMorgan Securities LLC

Q

100 – 100 credits.

Barb Godin
Senior Executive Vice President & Chief Credit Officer

A

Out of a book of approximately 1,300.

Vivek Juneja
JPMorgan Securities LLC

Q

Okay. Okay. Great. And then secondly, just for Grayson and David, let me turn back to the efficiency ratio question, when I look at your efficiency ratio calculation and add back the deposit administrative fee refund that you got, your core efficiency ratio is essentially flat with last quarter at roughly 65%, which is up almost 180 basis points from a year ago. And I know you're talking about it coming down into the low 60%s. How much of that decline, given that there's a lot of expense pressure which you've touched on and that investment that you're doing, so how much of the decline that you're expecting are you factoring in as coming from Fed rate hike benefit, I mean going from 65% to low 60%s, David or Grayson, how much do you expect would come from there?

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

A

Yeah, we don't have it broken out in terms of just related to the rate hike. What I will tell you is that the main driver of our efficiency ratio is growing our revenue appropriately. We do have expense measures that we're looking at, in that revenue growth is expecting those investments that we've made thus far to continue to generate the revenue growth, and we're seeing that. We saw that this quarter with 7% NIR growth, but we have people we hired, just an example, our financial consultants, we're up to 200, just got our 200th one, I think, this week. But it takes time for those new folks to generate the revenue that we expect. It's about eight or nine months.

So we carry that expense load until the revenue comes. And so, part of our getting into that lower 60%s is rate, part of it is continued execution from the people that are here. And then from the expense side, as I mentioned earlier in the call, continuing to look at the support groups, whether it be, again, finance, HR, risk management, credit teams, all that infrastructure that we look at, we continue to work to rationalize that, to use technology to help us deliver our products and services cheaper to our customer base. So all of that has to work together to get our efficiency ratio down into the lower 60%s. We really want to get to the higher 50%s. That does take a rate hike to get where we're in a normal rate environment, so that will take some time to get there.

Vivek Juneja
JPMorgan Securities LLC

Q

Okay, thank you.

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Operator: Your final question comes from the line of David Eads of UBS.

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

Good morning, David.

David Eads
UBS Securities LLC
Q

Hello. Thanks for taking the call. Just, I guess, a couple questions on the loan growth. Maybe on indirect auto, we've seen some talk about the CFPB and dealer markups on those loans. I'm curious what you guys do when it comes to dealer discretion on pricing, and then I guess more broadly, what you think that those moves could mean for competition across the industry?

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

Well, we have seen, I'll say, a change in some of our competitors in terms of dealer markups. Today, we give 200-basis-point discretion, which is a little lower than the average peer. An average peer has been in the 300s. They lower down at 250. So we're a little lower than peers. We have seen some go to flat. The industry really is looking, along with the captives, which have just come into the fold through the CFPB, to really give those of us that operate what the rules of the game are. And what I'll tell you is, we'll adapt and overcome, we just want to know what they are. We'll figure out how to make money in whatever environment it is. So, right now, I think there's a measured pace as to whether or not we go to flat or whether or not we go from 200 to 100 or some other basis. But I think that if you looked at our business, half of it only has 100 basis points of discretion in it. So we're positioned well to adapt to whatever the rules are. We just need some finalization to come from the regulatory side.

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

In other words – and I'll just add to what David said, we've done a number of things strategically to try to position ourselves better for what David has outlined as an industry that's under change, and we're trying to measure that change, interpret that change. So we've done some experimentation and some innovation around pricing. We've experimented with substantially reduced markups. We've experimented with something much lower than our standard. We've worked with our dealers and strategically, we've reduced the number of dealers we do business with to make sure that we've got large dealer groups that we've got confidence in the way they run the risk management part of their business. And we'll continue to make changes as the market changes. Today, though, the commercial banks are only about a third of that marketplace. And so, commercial banks are responding to it. It's still been a good market for us, but been very selective in who we do business with and what kind of business we'll place on the books.

David Eads
UBS Securities LLC
Q

Great. That's some good color. And then I think you guys broke out this other consumer indirect category this quarter. And I'm just kind of curious, you talk about that being partnerships with primarily home improvement retailers. Is that kind of going to have the characteristics of a home equity loan or a car loan and kind of what you're looking to do with that business?

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

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At its core, it's basically indirect lending through point-of-sale. And we partner with people who provide the front-end origination of those loans at retailers. And so, it's just an alternative source. As you see, there's a lot of change in the consumer lending space, a lot of digital offerings in the market. But there's also a lot of offerings that are taking place at point of purchase, if you will, and home improvement is a big issue for a lot of our customers, and but they want to get that financing when they walk into the home improvement store. And so, we've partnered to try to capture some of that. And so we're trying to be innovative in consumer lending and this is just an example of where we've had some good progress in that regard.

David Eads
UBS Securities LLC
Q

Great, thanks.

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

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

Listen, thank you for your questions. We very much appreciate your questions, appreciate your participation, your interest in Regions. And we look forward to speaking with you again next quarter. Thank you.

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

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