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RF - Q3 2014 Regions Financial Corp Earnings Call

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OVERVIEW:

Co. reported 3Q14 earnings of \$305m or \$0.22 per diluted share.



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PRESENTATION

Operator

Good morning and welcome to the Regions Financial Corporation quarterly earnings call. My name is Paula and I will be your operator for today's call. I would like to remind everyone that all participants' phone lines have been placed on listen-only. (Operator Instructions) I will now turn the call over to Mr. List Underwood to begin.

List Underwood - *Regions Financial Corporation - Director of IR*

Thank you, operator. And good morning, everyone. We appreciate your participation on our call today. Our presenters this morning are our Chief Executive Officer, Grayson Hall; and our Chief Financial Officer, David Turner. Other members of our management team are present as well and available to answer questions as appropriate. Also as part of the call this morning we will be referencing a slide presentation that is available under the investor relations section of Regions.com. Finally, let me remind you that in this call and potentially in the Q&A that follows we may make forward-looking statements which reflect our current views with respect to future events and financial performance. For further details please reference our forward-looking statement that is located in the appendix of the presentation. I will now turn it over to Grayson.



Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Thank you, List. And good morning, everyone. I appreciate your interest in Regions and participation in our third-quarter 2014 earnings conference call. Today we reported another solid and consistent quarter with earnings of \$305 million or \$0.22 per diluted share. Total revenue increased 2% and asset quality remained solid with a net charge-offs ratio of 39 basis points. We continue to focus on meeting the financial needs of our customers. And once again this quarter we grew our customer base and deepened relationships as evidenced by growth in quality households and quality checking accounts, all of which are fundamental drivers of long-term sustainable growth.

Although the overall lending environment was challenging in the third quarter, we remain committed to maintaining disciplined credit underwriting standards. Competition remains intense within the business lending, creating pressure on both price and structure. Nonetheless, we remain prudent in-house we choose to compete for loans. As a result, there are a number of deals that we are walking away from that do not meet the Company's risk appetite or have unacceptable returns. While we have experienced a slower demand in July and August, recent trends indicate a very favorable pickup in activity and have generally been more favorable both at the end of the quarter and as we enter the next quarter.

The consumer lending portfolio continued to expand including growth in indirect loans, credit card, and mortgages. Additionally, our deposit base continued to increase with ending deposit balances up \$308 million from the prior quarter. We remain focused on growing and diversifying our noninterest revenue. Despite the challenging environment we believe that allowing customers to bank the way they choose is the key to customer satisfaction and growth. We also recognize we must continue to innovate, as it is critical to attracting and retaining customers. We are committed to driving long-term growth while improving efficiency across the organization, supported by our process improvement initiatives.

Despite the recent market volatility and global macroeconomic weakness, we are encouraged by improving economic fundamentals throughout our core markets. Although recovery remains uneven, we expect increased capital spending activity will drive GDP growth into 2015.

Finally, we are encouraged and pleased with the recent announced positive actions by a couple of our credit rating agencies. We believe these actions reflect meaningful improvements in a number of credit quality metrics and our overall risk profile. We are committed to maintaining a strong risk management culture, and these rating upgrades are further evidence of our continued progress.

I will now turn it over to David for a closer look at our third-quarter results and then we will take your questions.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Thank you and good morning, everyone. Let's take a look at the details, starting with the balance sheet. Loan balances totaled \$77 billion at the end of the third quarter, an increase of \$94 million from the end of the previous quarter. The consumer lending portfolio drove the increase as growth in business lending moderated early in the quarter, as Grayson indicated. Total consumer lending increased \$120 million linked quarter as production increased 2%. The growth in the consumer portfolio was led by indirect auto lending as balances increased 4% from the prior quarter. We continue to benefit from the robust market for auto sales as well as from the process improvements instituted earlier in the year. As a result we expect further growth in this portfolio.

Credit card balances increased \$19 million or 2% from the previous quarter. This increase stems from a 4% increase in active card users. To date our marketing efforts have primarily targeted our existing customer base. As a result, we continue to make progress as our penetration rate is up 200 basis points to 15% over the last year, and we expect growth in balances to continue in the near term.

Mortgage balances were up modestly this quarter as production increased 1% linked quarter. Meanwhile, total home equity balances declined \$96 million as loan payoffs continue to outpace new production. However, total home equity production increased 13% from the previous quarter as customers continue to take advantage of fixed-rate home equity loans and variable-rate home equity lines of credit.

Looking at business lending, this portfolio totaled \$48 billion at the end of the quarter, an increase of 4% year-to-date. Commercial-industrial loans grew \$503 million or 2% from the prior quarter. As Grayson mentioned, competition remains intense in this space. In addition, we experienced loan payoffs related to customer mergers and acquisitions as well as refinancing activities occurring in the fixed income markets. C&I growth was

led by the general industries group within the geographies as well as REIT finance. Line utilization declined 40 basis points. However, commitments for new loans increased \$1 billion or 2% and our pipelines remain strong.

Regarding investor real estate, while ending balances are up 1% year to date at \$6.8 billion, the portfolio experienced a decline of 2% from the previous quarter. Investor real estate remains an important part of our corporate bank strategy, given our market presence in the Southeast. However, as previously noted, we remain committed to our risk tolerance levels as it relates to this portfolio. As such, near-term growth is expected to be modest. Based on what we know today and reflecting our current economic forecast, we expect ending 2014 loan growth to be at the lower end of the 3% to 5% range.

Let's take a look at deposits. Supported by our multichannel platform, deposits continue to grow, increasing \$308 million during the third quarter. Of note, low-cost deposits grew by \$492 million and continue to account for 91% of total deposits. Deposit costs remain at historically low levels and totaled 11 basis points, while total funding costs declined to 30 basis points in the quarter. And we continue to expect 2014 deposit growth to be in the 2% range for the year on a point-to-point basis.

Let's take a look at how this impacted our results. Net interest income on a fully taxable basis was \$837 million, essentially flat versus the prior quarter. However, as anticipated, our net interest margin declined six basis points to 3.18%. Net interest income benefited from an additional day in the quarter as well as from a modest increase in the securities portfolio. Net interest margin was negatively impacted by approximately 3 basis points due to higher levels of cash and the additional day. Both net interest margin and net interest income were negatively impacted by lower asset yields as maturities in paydowns and loans and securities are replaced at lower levels. Asset yields will likely continue to come under pressure if the current low interest rate environment persists. Deposit and funding cost are expected to remain stable at historically low levels with limited opportunity to realize additional cost leverage.

Assuming rates remain at roughly current levels through the fourth quarter, we expect to have net interest margin compression of 1 to 3 basis points and net interest income growth will primarily be driven by growth in loans. In terms of our interest rate sensitivity, we remain asset sensitive and expect net interest income to benefit from increases in short-term or longer-term rates. More specifically, a 100 basis point parallel shift in rates would increase net income approximately \$160 million in the first year. Total non-interest revenue increased 5% to \$478 million in the third quarter. Service charges increased 4% from the second quarter and cards and ATM fees increased 1%. Credit card income benefited from a 2% increase in spending volume.

Now, with respect to posting order, as we have previously stated, we plan to begin piloting a chronological approach in select markets during the first quarter next year. The results from these tests will be used to inform our posting order process and customer communications. We do not expect to fully implement these changes until the second half of 2015. However, through our current modeling efforts we estimate the impact from these changes to be in the range of \$10 million to \$15 million per quarter. It is important to understand that the modeling assumes a static environment and there are numerous policies, including funds availability, that impact fee revenue.

Mortgage income was down 9% from the previous quarter, primarily related to lower mortgage servicing rights and related hedge income. Although servicing income has been relatively consistent, we continue to look for opportunities to grow this revenue source. We currently have approximately \$40 billion of mortgages in our servicing portfolio and have the operational capacity to take on additional volume. While mortgage production declined in 2014, the pace of our decline has been less than the industry. Originations continue to be driven by new home purchases and represented on average 73% of total originations this year. And looking ahead, the Mortgage Bankers Association estimates that mortgage origination should increase 5% to 10% in 2015. And we expect to continue to outpace industry estimates.

Capital markets income increased \$8 million from the previous quarter, primarily related to an increase in activity in real estate capital markets. This increase reflects the revenue increase from investments we have made to expand our capital markets capabilities.

Let's move onto expenses. Adjusted expenses were flat from the previous quarter. Salaries and benefits increased \$13 million from the previous quarter as headcount increased 183 positions.



The majority of these positions are in revenue-generating or revenue support roles and include hires in specialty lending, insurance, wealth management, and platform personnel, and will drive future growth in revenue. The remaining portion of the increase continues to be primarily from hires of support staff, particularly in risk management and compliance functions. With that said, we continue to closely monitor personnel resources, which has resulted in a reduction in headcount of 656 positions year to date.

Credit expenses have been particularly low for several quarters as we have benefited from loan sales out of our held-for-sale portfolio. The opportunity for gains will diminish as the balances in the portfolio decline.

This quarter we also incurred expenses related to Visa class B shares sold in prior years, which resulted in \$7 million of additional expense in the third quarter.

Furniture and equipment expense -- related expense increased primarily related to investments in technology including systems enhancements and data management solutions. Additionally, we benefited from a recovery to expenses related to unfunded commitments of \$24 million, which was primarily due to a large credit line that funded and was subsequently resolved during the quarter.

The adjusted efficiency ratio improved by 60 basis points to 63.6% in the third quarter as we remain committed to driving efficiencies across the organization. While some quarter to quarter volatility is to be expected, we continue to expect full-year 2014 adjusted expenses to be lower than those of 2013.

Let's move onto asset quality. Our overall asset quality remains solid as many credit metrics improved in the quarter. Our nonperforming loans declined 7% linked quarter. In addition, at quarter end our loan-loss allowance to nonperforming loans or coverage ratio was 141%, up from 137% last quarter.

Total delinquencies declined 4% and troubled debt restructurings, or TDRs, meaningfully declined 7%, driven by both refinancing activity and paydowns. In addition, both criticized and classified loans declined from the prior quarter. Net charge-offs totaled \$75 million, representing 39 basis points of average loans. The provision for loan losses was \$24 million or \$51 million less than charge-offs, 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 12.7%, and our estimated Tier 1 common equity ratio was 11.8%. Further, we estimate our fully phased-in Basle III common equity tier 1 ratio to be 11.2%. And as previously mentioned, we expect to begin executing our \$350 million share repurchase program shortly, as we previously planned.

And just a quick note regarding preferred stock expense for the third quarter. Due to the timing of our April issuance, the first coupon period was longer than future coupon periods and resulted in additional expense of approximately \$4 million. Going forward with the current level of preferred stock outstanding, the run rate for preferred stock expense will be approximately \$16 million per quarter.

Liquidity at both the bank and the holding company remains solid with a low loan to deposit ratio of 81%. And regarding the liquidity coverage ratio rule, Regions funding base and investment portfolio are well positioned to receive optimal treatment based on the high-quality liquid asset definition. Importantly, our Regions 360 approach supports deepening customer relationships, which provides an LCR-friendly platform for the ratio calculation. Overall, we are pleased with certain adjustments made to the final rule and expect to be fully compliant by the January 2016 deadline without meaningful changes to our balance sheet.

In summary, our third-quarter results continue to reflect our steady progress in growing revenue while maintaining a disciplined risk culture. We believe that by focusing on our customers' needs while prudently managing risk, we will drive long-term sustainable growth and deliver long-term shareholder value.

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



List Underwood - *Regions Financial Corporation - Director of IR*

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Paul Miller of FBR Capital Markets.

Jessica Ribner - *FBR & Co. - Analyst*

It's actually Jessica Ribner in for Paul. It sounds like just from your comments your -- you sound more positive about 2015 than 2014 in terms of loan growth and earnings. Do you feel like you can improve on today's loan growth into next year? What are you guys seeing?

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Well, if you look at third quarter's, we said in our prepared remarks we saw a moderation of loan demand in July and August. And then we saw loan demand strengthen to some degree in September. We've continued to see that strengthening of loan demand into the fourth quarter. And certainly we are encouraged by that. I would tell you the moderation in the early part of the quarter was a mixture of both a number of merger and acquisition transactions where we either were not the bank of the acquirer, or we were the bank of both and had to reduce our hold positions on those.

But we also saw an overall reduction in demand and a related production as a result of that demand. And so there were a number of one-off transactions that we would not have anticipated in terms of payoffs or paydowns. But I would say generally in July or August we saw a reduced demand. That obviously concerned us early in the quarter but it restrengthened in September. And if the trend continues I think it's a very good sign for 2015 and obviously gives us the opportunity to perform at a higher level if that trends continues. And at this juncture, we have no reason to believe it will not.

And if the trend continues, I think it's a very good sign for 2015 and obviously gives us the opportunity to perform at higher level if that trend continues. And at this juncture we have no reason to believe it will not.

Jessica Ribner - *FBR & Co. - Analyst*

Okay, thanks so much.

Operator

Betsy Graseck of Morgan Stanley.

Betsy Graseck - *Morgan Stanley - Analyst*

Okay, a couple questions on the overdraft. You indicated that based on the testing that you've done that starting, I think, third quarter of 2015 you expect to see a \$10 million to \$15 million drop in your OD fees. Could you give us some color behind the analysis you did to get to that estimate



and maybe also indicate what the total OD fees are and let us know if you are going to be offsetting any of that revenue shrinkage with other actions.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

I'll start and then I'll let David add to that. We have spent the last several months making a number of fairly significant modifications to our deposit systems in order to accommodate posting order changes as well as to accommodate the testing and forecasting of those changes. All of those modifications have gone well, and we are in a much better position today to understand what the implications of these changes might be. We will start piloting a number of these changes, and in general, without getting too deep into the details, our approach is very much of a chronological-based approach to posting. And our early numbers would indicate it, as David said, that we could realize a \$10 million to \$15 million a quarter reduction in service charges.

That being said, we realize that it's our job to figure out how to mitigate those service charge reductions. A lot of it is going to depend on customer behavior. But also we are looking at all of our deposit-related products, how we price those products, and how we deliver those products. And we continue to believe that, as we have in the past, as we've made changes like this, to find ways to mitigate those leakages, if you will, of noninterest revenue. We had a good strong noninterest revenue quarter this quarter, and so we think we are making some of the right changes.

David?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes. Betsy, we really wanted to put something out there on posting orders. It's a question that we get frequently. It is based on running some models today. But we really need to see what the customer behavior is going to be before we know. And we will update you when we know. But we want to frame it up a little bit for you to try to head off the continued question there.

I will tell you that through a lot of changes that have happened in our industry we've had almost \$400 million worth of revenue taken out of our Company that we've had to overcome. We've created new products and services, and we will do the same thing here as well. So we have the teams working hard to grow our revenue regardless of changes that we see, whether it be posting order or other changes we have to deal with. And so we don't have specifics on this just yet, but we will continue to update you and find ways to mitigate this revenue. And we will give you -- as we get closer and run the pilot, we will give you better information, too, to hone in on this number.

Betsy Graseck - *Morgan Stanley - Analyst*

I guess, is there -- just if you can share with us anything regarding some of the assumptions that are behind the \$10 million to \$15 million? Is it a reduction in fee waivers? This is obviously a less bad number than some folks had been wondering or estimating out there. So I'm just wondering if you could help us with some of those details.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Well, I think that clearly, as we went through our most recent assumptions and testing, that we've assumed a pretty static environment and that we are not putting assumptions in the model today that would be indicative of customer behavioral changes. We are assuming that behaviors continue the way they have. We are not putting assumptions in there that we have less account attrition, which is a potential. If this policy for some customers will be perceived as more friendly, then you could argue that there's some account retention benefit, but we have not modeled that in. So I think we've taken a very conservative approach to how we've modeled this.

That being said, the best numbers will come when we actually pilot this in the first quarter. And that pilot is really going to give us a much clearer view of that. I think that the primary issue in our part is being very transparent with our customers, making sure that we understand how this impacts customers and making sure that we don't lose our momentum in growing accounts, as we have been throughout 2014.

Betsy Graseck - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

John McDonald of Sanford Bernstein.

John McDonald - *Sanford Bernstein & Company - Analyst*

I was wondering about the buyback. Is your intention to utilize the full \$350 million in buybacks over the remaining two quarters of the CCAR period?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

That is what's in the plan, yes.

John McDonald - *Sanford Bernstein & Company - Analyst*

Okay. And then on the deposit services, switching gears to the Ready Advance, could you update us on how much in the Ready Advance fees might have in the third quarter? I believe it was \$6 million in PPNR in the second quarter. How does that trend in the third and what's the timeline for that going away?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

So we've -- so the change in the third quarter and the second quarter -- pretty similar numbers that we had previously spoken about. We will have, by the end of the year we will have converted everybody or stopped the Ready Advance program. Really by the end of November we will have discontinued that. And we put forth other options for those existing customers on the Ready Advance product that they have today.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

If you recall, we stopped offering that product in January of this year, and we have gone through a couple of conversions. We broke the customer base up into segments. We've gone through a couple conversions. All those conversions will be completed before the end of the year. I would say that the drop-off you saw from first-quarter to second-quarter was predominantly because of the reduced enrollments. You could have took enrollments to zero. The drop-off you saw really from second to third quarter had to do with some limited amount of conversions.

We still have -- of customers that we had in that product, probably 60% of those customers are still active today. But all of those customers will be converted, as David said, near the end of November. And none of that will be in our run rate for first quarter; there will still be a limited amount in our run rate for the fourth quarter.



David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes, in that product.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

In that product.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

But they will be taking other products, and then we will have -- we will move some revenue from NIR up into NII. And that will be based on adoption rates for those customers.

John McDonald - *Sanford Bernstein & Company - Analyst*

Okay. And that should happen partially in the fourth and then again in the first?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

That's correct.

John McDonald - *Sanford Bernstein & Company - Analyst*

Okay. And then just to clarify Betsy's, on the posting order changes -- we assume that \$10 million to \$15 million -- we should start that in the third quarter of next year?

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

You will have a very limited amount in the first half of the year and the rest of that, balance of that will be in the third and fourth quarter of next year.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

And that's the plan right now. We will learn through our --

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

We will learn through the pilot.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

-- Through the pilot. So we are giving you the best information we have today and with the right to come back and modify accordingly.



John McDonald - *Sanford Bernstein & Company - Analyst*

Okay. Thank you. And one more thing on the buyback, David -- just anything in the -- you mentioned the 350 buybacks are in the plan. Is there anything that would prevent you from doing that, that you can foresee?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

No, I don't.

John McDonald - *Sanford Bernstein & Company - Analyst*

Okay, thank you.

Operator

Matt O'Connor of Deutsche Bank.

Matt O'Connor - *Deutsche Bank - Analyst*

If I could just circle back on the expenses, obviously good progress here. And as you think about the full-year guidance of down year over year, you have been down pretty materially year to date. So maybe boxing it in a little bit more for the fourth quarter if you are comfortable doing so and then thinking about the trajectory for next year?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes. Matt, we are still working on next year. We will update you on that as we get closer towards the end of the year. We have a couple of conference is coming up and we will let everybody know. As it relates to our general philosophy, as you know, we were wanting to generate positive operating leverage. We have one of the lowest expense basis. But, that being said, we focus on it quite a bit. That does not prevent us from making investments where we see the need to do that. As I've mentioned in my prepared comments, we've made -- we increased positions about 183 this quarter. And we put most of that in our revenue-producing or revenue support roles because we think that's the right thing to do. And at times you will see the expenses come before the revenue.

We had the same issue about this time last year where we've tried to indicate we were going to make some investments. We feel very good about that. And so long-term we think we are doing the right thing.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Matt, we really are trying to take a very balanced approach both from a revenue and an expense standpoint. We realize that there clearly are investments that we have to make to grow and to manage our business better. But there's also opportunities for us to continue to increase the efficiency of our Company. And so we take this very balanced approach to it, to try to, if you will, fund our investments through savings efficiencies.

We have been very aggressive, as you know, over the last several years in branch rationalization. We do that on an annual basis. We are going through that process now, as we speak. And we are being more rigorous, more disciplined about that this year. Over the past seven years we have closed little over 19% or consolidated a little over 19% of our branch offices. You will see us continue to leverage that process to drive even more efficiency through our Company.



We still believe the branch is a very relevant channel. We are investing in all of our channels including the branch channel. But we also believe that we have to manage those channels pretty dynamically. And so, as David said, as we get closer to the end of the year, through the appropriate opportunities we look to update you on some of our cost efficiency initiatives. And we realize in this kind of low rate environment that we've got to continue to drive that forward.

Matt O'Connor - Deutsche Bank - Analyst

As we think specifically about the third-quarter expense base, the adjusted \$826 million, is that a reasonable kind of run rate or base? Or should we gross that up for the provision for unfunded credit losses that was a credit?

David Turner - Regions Financial Corporation - Senior EVP and CFO

Matt, without giving you -- you've got to build your run rate expectations. We don't want to give specific guidance there. But I do think you need to factor in the unfunded commitment because that's a credit, a one-time credit that may or may not recur. As you can tell if you look at that other expense line item we have, it's pretty lumpy. And it's because of that expense and unfunded commitment.

So that's \$24 million going one way. We did have the Visa expense of \$7 million that went the other way. And that shouldn't be recurring every quarter, but we have had that from time to time. So that's lumpy as well. That's a net \$17 million that I think you ought to consider as you evaluate what you think our run rate would be.

Matt O'Connor - Deutsche Bank - Analyst

Okay. All right, thank you.

Operator

Marty Mosby of Vining Sparks.

Marty Mosby - Vining Sparks - Analyst

I had a couple different questions. One is, with the rating agency changes positively, David, do you think you could become a little more aggressive maybe in using excess capital to start pulling down those debt cost and refinancing your debt, given the improvement you are seeing there?

David Turner - Regions Financial Corporation - Senior EVP and CFO

Marty, that's a great question. We look at trying to get more efficient, if you will, from that funding cost standpoint. As you know, we paid a little over 5% after considering swaps. It's whatever page it is in our supplement. We look at that all the time. And when the economics are right, notwithstanding the rating agencies, if it makes economic sense for us to do that, we would love to take that out, use our capital, as you mentioned, and have a better run rate going forward.

But it has to make economic sense. As the rates have continued to come down it's gotten a little less economical for us. But we look at it literally every day. So your comment is spot on.

From the rating agency standpoint we have got some improvement out of the rating agencies. And we are looking to leverage, hopefully, over time even better ratings as we deal with our customers and also as we deal with getting our debt structure, if you will, as efficient low cost as we can.

Marty Mosby - *Vining Sparks - Analyst*

And then, Grayson, we had talked earlier this year about the strategy of how you were looking at your customers differently in the sense of what they liked, what types of customers they were. And you are talking about growing your customer base and deepening relationships. How are you seeing your new approach to the market and the customers as an advantage now to maybe serve a little bit more the underserved mass market in your markets?

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Marty, as we've spoken before, we are servicing a little over 4 million households today. We have a little over 5 million customers. And we are constantly trying to think through ways that we can be innovative from a product or delivery standpoint to increase our satisfaction or our delivery of customer needs. And we've offered a number of alternative products to try to bank more of the un-banked or under-banked.

Obviously, we have a lot of competition in that space. As you may recall, we introduced a suite of banking products directed right at that segment called Now Banking. And our Now Banking accounts for some 460,000 customers that we've added to that product suite. And we continue to see progress. As you saw from our numbers this time, we are growing households, growing accounts. We've got a number of borrowing segments that are growing as well as our depository segments are growing.

We believe we're making good progress. I would tell you it's early, though, as we have rolled out this new strategy, and I would say we are in the early innings of this. But the progress is good.

And recently, to try to meet the liquidity needs of some of our customer segments we rolled out a Secured Savings lending product and already have some 25,000 customers who have registered for that product. So we are still trying to innovate in an environment that will meet customer needs.

I think your question is a great question because at the end of the day the only way you have a sustainable businesses is to be able to grow our customer base.

Marty Mosby - *Vining Sparks - Analyst*

Thanks.

Operator

Ken Usdin of Jefferies.

Ken Usdin - *Jefferies & Company - Analyst*

David, I was wondering. To your comments about -- I know this is wrapped up in your general NIM guidance. But can you talk to us about, if rates stay as low as they are, the impact from the 10-year, whether it's on what you're go-to reinvestment yields are, where premium amortization was this quarter and where it goes, and any effect on the pension expense for next year?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes. Let me start with the last one first. So pension clearly is rate driven and we will have to see what that looks like. I would caution you we were low last year about this time and rates spiked towards the end of the year, which helped everybody's pension calculations. So it's a little premature, but you are spot on. A lower rate environment does cause an increase, net-net, of pension expense.

So we are going to watch that. It's too early to give you guidance on it. It will be embedded in what we give later on in the year when we start going to the last couple of conferences.

I think from an overall NIM standpoint rates are lower than what we had anticipated right now. We've done a lot of modeling to figure out what that might mean to us. And we've given you the guidance for the fourth quarter in that 1 to 3, which may persist into the first quarter. So we think we can do that 1 to 3 maybe even through that first quarter.

And I will tell you, Ken, this has been so volatile we just need to wait and give us a little bit of time and see what happens. If you look at, really, the domestic economy, everything points to a higher rate environment. But you have to start factoring in the geopolitical issues that are going on, the economies around the world. And so we are in a tough spot.

And of course, what is the Fed going to do over time? So we think -- we believe rates will increase at some point, timing of which is uncertain. We continue to be asset sensitive. We think that's the right thing to do. But if rates stay low longer we will continue, as everybody else will, to have pressure on NII and resulting margin. That 1 to 3, right now, I think could carry us a couple of quarters.

Ken Usdin - *Jefferies & Company - Analyst*

And within that can you just tell us what the premium amortization number is for this quarter? And is any change to that built into your outlook?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

It is. Our premium amortization did increase bit over the quarter. We [earned] about \$40 million of amortization this quarter. And I think last quarter was \$36 million. So it did pick up a bit. But that is built into our overall guidance.

Ken Usdin - *Jefferies & Company - Analyst*

Okay. And then my other question is just about you have still a couple of sizable loan categories that continue to shrink well past, I think, anyone's original expectations, whether it's the owner-occupied bucket, the commercial real estate mortgage, and then the second-lien home equity. Any line of sight in terms of finally getting to the bottom on those categories from originations versus runoff perspective?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Ken, let's take owner-occupied real estate. That generally is our small business customer. And small business formation has been down in 2014 quite a bit. And we really need to see and want to see the demand from that customer. It is our bread-and-butter. It is really a segment that we can demonstrate our Regions 360 that we talked about just a minute ago with Marty's question, and a lot of services that that customer base needs.

The problem is we just don't see that demand. We see reluctance as we talk to those customers in terms of wanting to borrow for expansion, given all the uncertainty that exists -- whether it's political, whether it's domestic, whether it's what's going on in Europe, all kind -- Ebola. All kinds of issues are factoring into the concerns of the small business owner.

So, we are going to work really hard, have been. We are going to step it up even more so in terms of that owner-occupied base to deal with what the main issue is, and that is amortization. Those have a tendency to be term loans that amortize. And so you have to have production going just to stay even. So we think we can slow that decline.

The home equity second lien -- some of that has been -- a lot of that has been refinanced away. Some of it is deleveraging by the consumer. We have started to see that pace of decline, decline slower than it has been over the early part of the year. Some of that has gone into our new product, our home equity loan product. And so we think those are the two, we hope, over time in the balance of 2015 that we see those declines slowdown. And that married with the production, we think we can have a reasonable forecast of loan growth in 2015, that of which we will update you on again towards the end of the year.

Ken Usdin - *Jefferies & Company - Analyst*

For all that color, David, appreciate it.

Operator

Sameer Gokhale of Janney Capital Markets.

Sameer Gokhale - *Janney Capital Markets - Analyst*

A couple of questions -- the first one, just to go back to the idea, the buybacks. And I was curious about your thinking behind buybacks, why you didn't buy back any stock, it looks like, in Q2 and Q3. Clearly, you had the authorization in place certainly for this quarter. But how are you thinking about buybacks? You are going to buy back more stock. But I didn't you buyback anything in Q2? If you would just help me think about that, given that loan growth -- I don't think it was particularly strong. So were you anticipating faster growth? And how should we think about that? It just seems like you have a lot of excess capital here. Perspective would be helpful.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

I'll say a few words and ask David to do it. We put our capital plan together roughly a year ago; it was in the fourth quarter of last year and we put that capital plan together. We clearly had to make some assumptions around what we thought the forecast for economic activity was going to be. And quite frankly, some of the things have turned out better than we forecasted, some worse.

Clearly, the economy's recovery has been slower than we anticipated. Our organic loan growth has not then as strong as we had thought that they would potentially be at that point in time. And alternative investments have not turned out to be as strong as we might have liked.

That being said, we were very confident in our plan. We felt like it gave us an awful lot of flexibility. We thought it would us in a position to continue to strengthen our balance sheet, strengthen our capital position. And we were confident in that plan and we have been executing that plan. As David said, now we are at the point where we are ready to finish off the tasks we had put into that plan.

I know there has in some questions about why we planned it that way and why we backend loaded this. But again, we use the best forecasts we thought we had. And we still are confident that it was a good plan.

David?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes; I think going into the year loan growth -- if you go back to the first quarter, loan growth was more robust for us. We really want to deploy our capital to grow our business. We think that's why the shareholders gave us the capital to begin with. And giving it back to the shareholders is what we will do when we haven't been able to deploy it otherwise. So we put it intentionally in the back half, in the back half of the plan. And we had no objection to that plan and we are executing in accordance with that.

Once you build the plan and submit the plan, that's what the plan is. There's not really an opportunity to go back and change that plan easily. So we're going to execute in accordance with it, and you should see us wrap that up by the first quarter of 2015.

Sameer Gokhale - *Janney Capital Markets - Analyst*

Okay, that's very helpful. And then I'm going to ask you a question that's more of a high-level question and one that I could probably ask CEOs of other banks as well, Grayson. But what I would love to get your perspective on is that you and other banks have been focused on the efficiency ratio and lowering expenses. And of course I think in any cycle, any given point in time, banks would like to be more efficient rather than less efficient. I think that goes without saying.

But having said that, as you think about your business and you think about the environment we are in, it sounds like you might, with your reductions in headcount -- and this probably applies more generally across the board. It suggests that you and other CEOs really aren't very optimistic at all about growth going forward. And I know the hope is that interest rates at some point will increase and give a top-line benefit. But having said that, from a business planning standpoint, how do you think about continuing to reduce headcount going forward in terms of running the business -- you seem to be planning for more of a continued slowdown going forward. Is that accurate? I would just love to get your thoughts on that. Thank you.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

I appreciate the question. I think it's a great question, and I think it's one that a lot of banks are trying to answer. I think my answer would be more optimistic than the picture you just painted. I think that we are seeing the opportunity to grow our business. We are seeing, in the markets we operate in, given the strengths of the market that we operate in, we believe we got an opportunity to grow our business. And we do believe that, while the economy is improving slowly, it still is improving. And we are seeing signs of that improvement across all of our markets.

I've said it internally and I'll say it externally. We have made a lot of progress, but we still have a lot of work to do. I don't believe we've even started to really demonstrate what the power of this franchise can be going forward. I think the progress we've made in 2014 really lays a solid foundation for what we can potentially do in 2015.

But we are growing customers. We are growing households. We are growing our business. I think the third quarter was slower from a loan demand than we had anticipated. But if the trend continues we are a lot more optimistic for the fourth quarter, knowing what we know today.

So, all that being said, as optimistic as we are, we still have to be prudent. And I think that we have to have this balanced approach to both investing to grow but looking for efficiencies around the company that allow us, if you will, to be able to hedge that, hedge that forecast.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes. I would add that I do think the investments in the people that we've made -- and I mentioned that on the comments, roughly 183 during the quarter -- but we have done some things to cut back on headcount. So we had consolidated 30 branches. We started that in the fourth quarter last year, finished up in the first quarter of 2014. And when we do that we have a reduction in staffing levels as a result of that.



So that's an example of where we use our excess capital. We take a charge for that, but then we are able to consolidate and get a reasonably quick payback as we consolidate and take those customers from one branch into another. So just looking at headcount numbers can be a little misleading in terms of what our commitment is to grow our business because we believe our biggest opportunity is revenue growth, and we will get that by making prudent investments in people and businesses going forward.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

But it's not just people. Our physical footprint -- we are down under 15 million square feet. We continue to find opportunities to reduce our physical footprint by 10% to 15% a year and we think that continues. We are operating in a smaller physical presence. A lot of the branches are smaller. We have fewer branches. But we also are doing the same thing in office space. In our back offices we are continuing to consolidate space. And there's a number of different examples of the way we are trying to make sure that we've got efficiency across the Company.

Sameer Gokhale - *Janney Capital Markets - Analyst*

Okay. Thank you again. I appreciate your responses. I know I could have asked that of pretty much any CEO, and your perspective is very helpful.

And then just a last quick one, if I may -- your capital markets pipeline going into Q4 -- I know the revenues were up a little bit. But do you see that spend continuing into Q4? Thank you.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Yes. I think we've made a pretty sizable investment in people and product in our capital management group and our capital markets group. And obviously one of the bigger products in that group has been -- in this interest rate environment has not been there for us. But I think a little movement in rates and we could see a lot more production out of that group. But nevertheless, with the investments we've made, we continue to think we're going to grow the revenue out of that business.

Sameer Gokhale - *Janney Capital Markets - Analyst*

Okay, thank you.

Operator

Michael Rose of Raymond James.

Michael Rose - *Raymond James & Associates, Inc. - Analyst*

Just going back to the expenses, how should we think about the environmental cost? Are we back close to kind of pre-cycle normalized levels? Are there some more levers that you can pull to reduce some of those costs?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

We always can reduce costs and build efficiencies. We do that. We have a whole team; that's what they are focused on, helping each business, each support area look at how we might improve workflow. It gets harder from where we are. We've worked over the past few years reducing our overall expenses to support our business. But, that being said, we can continue to do that.



Over time we've mentioned our overall efficiency ratio being, with a rate increase, in the 55% to 60% area. We are at 63% and change today. We have a group that we've invested in. It's a Six Sigma group that is looking for process improvement to do two things -- one, to increase revenue. And we mentioned that, I think, on our last call, where we've changed process and it helped us increase revenue in things like indirect auto. And we have also used them to help from an efficiency standpoint on the cost side.

So I think we can always look at how to improve there. We have had changes in our OREO and held-for-sale credit-related expenses there. We have had some benefits through gains on sale that don't repeat. And those are harder to replace. Now, we do focus on consulting expense. We are focused on our legal expense. And all those we have opportunities to continue to wind down or reduce over time.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

And Michael, I would tell you that I agree with everything David said, but there's one additional area. If you look at the investment we've made in risk management and compliance, this industry has faced a lot of new rules. And as we've gone through those new rules and regulations we've used an awful lot of human resource to ensure compliance with those rules and regulations. And as we have opportunity to invest in technology and mechanize a lot of these processes, there's going to be some efficiencies. And that's a tremendous effort on the part of our Company today is to find out how we can improve compliance and risk efficiencies through automation.

Michael Rose - *Raymond James & Associates, Inc. - Analyst*

Okay, that's helpful. And then, Grayson, as a follow-up you've historically talked about having a more balanced not mix between business and consumer. Can you update us on any sort of thoughts there and what the puts or takes are in getting there over time? Thanks.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Yes. We've been stating that desire strategically for some time, that we would love to achieve a greater balance between business and consumer on our balance sheet in terms of loans outstanding. We have made a tremendous number of investments in consumer lending products to try to accelerate that remixing, if you will, of the balance sheet. As you've seen, we have not in particularly successful at that. Business loans have been -- there has been more demand on the business loan side of our customer base. And as a consequence, our progress in that regard has been somewhat muted. Long-term, we still have that as a strategic desire on our part to achieve a better mix.

That being said, we have to take advantage of what the market offers us in any given economy. And so it's still a goal that we are working on but not there yet.

Michael Rose - *Raymond James & Associates, Inc. - Analyst*

Thank you.

Operator

Erika Najarian of Bank of America.

Erika Najarian - *BofA Merrill Lynch - Analyst*

My first question, just on the LCR, David -- how much is the securities portfolio going to grow as you march towards compliance in 2015? Or are we really going to see a remix of your balance into HQLA? And I assume that the 1 to 3 basis points in terms of forward guidance for the NIM considers that?



David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes, Erika, it did in fact consider that. We see very little change in mix. I was trying to address that earlier in my comments -- that we have a pretty large securities book. We were happy with the rules that came out. And we don't see any problems becoming compliant in 2016 without any meaningful changes to our balance sheet mix. So, you shouldn't expect any type of significant change or increase in our securities book.

Erika Najarian - *BofA Merrill Lynch - Analyst*

Got it. And just wanted to follow up to Ken's question. Another institution had helped us think about the potential incremental cost of funding your pension next year by giving us some guidance on -- for every 25 basis point increase in the discount rate, that that would turn into an incremental cost of X. Could you similarly help us think about that impact next year?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

We will. I don't have that committed to memory. We do have some sensitivity in our 10-K that would be a little helpful in terms of what the change in the discount rate does. So that would be a place that you could go look. But I'll have List and Dana follow up on that.

Erika Najarian - *BofA Merrill Lynch - Analyst*

Great, thank you.

Operator

Matt Burnell of Wells Fargo Securities.

Matt Burnell - *Wells Fargo Securities, LLC - Analyst*

Just, David, maybe a question for you -- you noted that the 100 basis point increase in the curve would generate about \$160 million of incremental NII. If I'm reading the 10-Q correctly, that's up from about \$111 million three months ago. Could you give us a little more color as to what the components were that drove that increase?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Matt, I'm not sure what you are looking at. You should have actually seen it come down. We had about 6% change in NII as a result of a 100 basis point parallel shift, which was about \$190 million the quarter before, coming down to about \$160 million, I think is what that should have -- we will go back and take a look at that. But we essentially took a little bit of our asset sensitivity off with trying to protect ourselves a little bit on the down rate environment. It proved to be the right move, given where we are today. But I think that it's really -- we are still pretty asset sensitive at about 5% of NII. So we took one point off, in round numbers, from the second to the third quarter.

Matt Burnell - *Wells Fargo Securities, LLC - Analyst*

Okay. My apologies. I'll follow up with List on that. And then just on fee revenue, a couple of the other banks that have already reported have suggested, even though it's very early days in the fourth quarter, the lower rate environment has actually generated some positive growth in refinancing volume. I'm curious if you can give us some color as to how you are thinking about the mortgage banking fee revenue line heading into the fourth quarter.



Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Absolutely, we have been looking at mortgage rates and the opportunity as rates have moved to a more favorable position for debt business that the refinance opportunity could accelerate. I would say that we haven't seen that shift yet, but we do anticipate that if the rates continue to stay at this level, that over the next few weeks we will see an increase in refinance.

As you may recall, refinance has been a lower percentage of our production than most of our peers. And so it will probably have a more muted impact on us than some of the peers that you are looking at. But we do anticipate an increase in refinance activity. But it also makes home affordability for the repurchase better as well.

So we think it's good for the mortgage business. I'll ask David, do you want to give any specific comments on?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes. I think, one, we need to let this settle a bit and see whether the mortgage rates actually follow and for how long. It takes a while for all that to get into the market. Clearly, if you are resetting 15-year rates in the 3% range or below and the 30-year rates in the 4% range or slightly underneath that, you will see another wave of refinance activity. If you look at our supplement on page 9 you'll see our refinance activity did pick up a bit in the second quarter -- I'm sorry, the third quarter. We're up about 7% from where we were in the second quarter. It's hard to tell, though, whether that's just really rate driven or just normal activity coming through in the third quarter. So, we are looking into that. We will give you better guidance as we see what the impact might be.

Matt Burnell - *Wells Fargo Securities, LLC - Analyst*

That's helpful color. Thank you.

Operator

Gerard Cassidy of RBC.

Gerard Cassidy - *RBC Capital Markets - Analyst*

The first question is circling back to your comments about loan growth. Clearly, on a year-over-year basis the loan growth has been very muted and it's below the industry loan growth as evidenced by the HA data we receive from the Federal Reserve on a weekly basis. Would you say that the slower loan growth is more due to your customers? You indicated some of your customers are still concerned about the operating environment. Or is it more your more conservative underwriting standards you are using that maybe your competitors are not?

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

I think it's a combination of factors. I think one is that most of the loan growth over the past several quarters has been in the upper end of the commercial middle market and into the corporate space, which we are very active there. But candidly, the bulk of our business has been in the middle-market and into the small business owners. And we mentioned a moment ago -- I think David spoke about it -- we have not seen the strength of the small business owner come back yet like we have other parts of the business.

So I think one is just a mix of our customer base that has caused us to be a little bit more muted or more moderate than some of our competitors. I think also, given what this organization has gone through over the past several years, we just very disciplined, very prudent about credit underwriting



at this juncture. So we would attribute part of our differential between some of the peers to be the credit culture that we have tried to build at this Company.

And I think the third issue -- and we alluded to it earlier -- there were a number of one-off transactions in the third quarter that we had not anticipated and are not a normal part of our portfolio. And that was a factor.

And I think the last point was that we did just see and I think many of our competitors acknowledge this as well, as third quarter was more moderate than anticipated.

All that being said, again, we are pretty optimistic at this juncture, given the way the last month of the quarter performed and the way the early days of the next quarter are starting to perform. So, we feel better today about where the economy is headed.

Gerard Cassidy - *RBC Capital Markets - Analyst*

Grayson, have you seen any evidence -- obviously, you guys monitor your customer base very carefully over the years -- that you are actually losing customers to competitors because they are being much more aggressive in their underwriting standards?

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

No. I would say that we think that our numbers would indicate very clearly we are still growing our customer base and still deepening the relationships we have with existing customers. And we spent an awful lot of time not only analyzing transactions that we win but also transactions we lose. And quite frankly, we aren't winning as many prospect transactions as we would like to. And that's probably true of every competitor we've got. We all are wanting to win new customer relationships that make sense for the customer and make sense for us.

I would say that we've seen more non-bank competitors enter into our space than we've seen before. There's a tremendous amount of liquidity in the marketplace, and so you do see not only competition from nonbanks but you see competition from the debt markets. And, that being said, we have to compete and we have to adjust and we are doing that. And our loan growth may be more moderate than we had anticipated. But we still have growth and we still anticipate growing our outstandings.

Gerard Cassidy - *RBC Capital Markets - Analyst*

Then my other question is, on the capital obviously your capital ratios are very strong with your Basel III Tier 1 number again over 11%. Do you guys ever see a day when you can give back more of that so that it comes down to a number you are more comfortable with? You look at your return on equity today on a stated look basis and it's under 8%. Your stock obviously trades at a discount to book, suggesting you are not earning your cost of capital. I know on a return on tangible common equity you are up over 9%.

But how you get rid of all this excess equity? When you look out over the next three years, let's say, because I know the CCAR has a lot to do with how much you can give back and you are limited to maybe your earnings in a current year. But what do you guys envision on how to get rid of that excess equity to get ROE up to a point where your stock in trade above book value?

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

It's a great question. And I'll tell you, I'd rather have that problem than being on the other side of the fence --

Gerard Cassidy - *RBC Capital Markets - Analyst*

I agree.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

-- Which is where we were at times. So we do acknowledge that having excess capital is not doing us any good and that we need to have an optimal capital stack. That means not only in total but the components that make up that. And we will adjust that over time in both the components of the capital stack as well as the sheer number. It's obviously a little more difficult to work, given how we have to approach capital or at least how we perceive we need to approach capital relative to CCAR.

But how we manage our capital -- that's our call. That's what our Board does. We have a whole process. And I do think over time you will see this capital numbers rationalize. It will be through a combination of utilizing that capital to grow our business, which is really what we want to do when the opportunity is there.

We talked about having acquisitions of product lines like we did our credit card portfolio a few years ago. We looked at using that capital to buy nonbanks. We are looking at bank acquisitions when those opportunities arise, and then returning it to the shareholders so that we don't keep piling it out because we realize the returns on tangible common over time, with the denominator continuing to grow, becomes pretty difficult. So we will and do envision the time where we can rationalize.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

But I think you look at it, and I think we are in a transition phase. Our capital planning process has gotten much more formal, much more sophisticated. And our confidence in that capital [prime] process is much higher today and it continues to improve. And at the same time we've derisked our loan portfolio tremendously. And so, we have more confidence and how our loan portfolio will perform going forward. All of those are things that give us confidence in how best to deploy capital and at what level to deploy it.

As we get a better economy, it would be our hope that we would have more organic opportunities to deploy that capital. But I also think, as the economy recovers, that we are going to have opportunities, as David said, to acquire. And how you define what we acquire will be a mix of opportunities. But I think, at the end of the day, if those things don't prove to fruition, then we have the opportunity to return that to shareholders in the form of dividends or buybacks. And I think that we are in a transition that's a little bit uncertain but gets more certain each and every day.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

And Gerard, I will add one last thing. And you mentioned cost of capital. Our goal clearly is to reduce our cost of capital. And that comes with a good, sustainable performance, solid performance quarter in and quarter out such that our cash flows are more predictable. And we think we've done that, but the market is saying not quite yet. And we hope over time the market realizes our sustainability of those cash flows to get our cost of capital down and, again, optimizing the capital stack would be another way to get the cost of capital down. And we will do that.

Gerard Cassidy - *RBC Capital Markets - Analyst*

Guys, thank you very much.

Operator

Geoffrey Elliott of Autonomous Research.

Geoffrey Elliott - *Autonomous Research LLP - Analyst*

My questions have already been answered. Thank you.

Operator

John Pancari of Evercore.

John Pancari - *Evercore Partners - Analyst*

Just a quick question around margin -- can you give a little more color on the increase in the interest-bearing deposit costs in the quarter? It looks like a couple items went up including your CD costs, by about four bps or so. I wanted to get a little bit of detail on why we are starting to see a lift in some of these deposit items.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

There's really no story there. That could just be mix on a given customer. We have run some tests to try to see what might happen to go longer on some CDs, in particular, to see what the market's acceptability to have some of those. So that could be a piece of it. But there's really not a big story there or a trend that you should expect going forward there.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

But we have run some market tests. Obviously, one of the risks we have is when rates go up, what sort of pressure does that put on customer deposits. And we've run a number of sensitivity tests in some markets to be able to prove our theories. And so you will see some of the interest rate numbers individually go up as a result of some of those tests. But they are temporary in nature, and overall our deposit costs continues to remain stable.

John Pancari - *Evercore Partners - Analyst*

Okay. All right. And then secondly, also on the margin, on the securities yields I just want to confirm that the bulk of that 11 basis points decline linked quarter -- what drove that and how much of that was premium amortization in terms of the bps impact on the yield, and then also curious about your new pricing or your pricing on your new auto loan originations or spreads, if you can't give us the upfront yields. Thanks.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

Yes. So the securities yield being down 11 basis points is obviously reinvesting in just a lower rate environment. But the premium amortization is also about half of that number. We did also shift out of corporate bonds as spreads changed. And we think that that was the right thing to do. So you can see our corporate bond portfolio will have declined.

You asked about auto spreads. There's really no change there. Obviously, it's a very competitive environment that we see in indirect auto. But we had about seven basis points contraction during the quarter, but we still feel good about that overall yield and spread that we have.

I think you can just see -- those can change on you, depending on what mix you are putting on the books. But our overall yield on that indirect, as you see in our supplement, is 3.39% versus 3.46% last quarter.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Yes. And as that market segment becomes more competitive, we have adjusted our pricing strategies to ensure that we've got the right mix of tenor and rate and that it's appropriately risk-based priced. And so you will see a little bit of shift in yield as we adjust our strategy because we want to make sure that we are staying in the right part of that market.

John Pancari - *Evercore Partners - Analyst*

Okay, thanks for taking my questions. I know the call is running long.

Operator

Richard Bove of Rafferty Capital.

Richard Bove - *Rafferty Capital Markets - Analyst*

I'm sorry to ask you a question after such a long meeting. But I am looking at these peer-to-peer companies and considering the fact that apparently the GSEs are now going to buy mortgages that have 3% to 5% down payments. And given your large, if you will, customer base in the -- we'll say the under-banked, I'm wondering if a bank can get into the peer-to-peer business, number one; and, number two, if this reduction in the down payments to nonqualified mortgage levels allows some opportunity there.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Dick, you are real familiar with the markets we up rate in across the Southeast. And we think it's a valuable franchise because of those markets. But we obviously operate in some rural communities where the opportunities are a little different maybe than some of our peers see. And I do think that there are ample opportunities in our market to be able to bank some customers that typically would not have qualified for mortgages. And we have been very methodical about the way we've approach that market in prudent about it.

Obviously, the GSEs are going to change the rules. We're watching that very closely. It would appear -- we are reading some of the same reports you are -- appear that there are pretty close to agreement on how to do that and what the rules are on that. And I think we are very interested. If we can understand the rules and agree what risk we are taking, if we can make the economics work out on it, and we are encouraged. And I do think you are absolutely correct. It's an opportunity for our franchise.

Richard Bove - *Rafferty Capital Markets - Analyst*

And the company I was thinking -- this lending club is about to go public. And I was looking at the prospectus and they are charging up to 20% rate on people who have FICO scores in the mid-600s. And they are not making the loans; they are shifting the loan -- they are a facilitator. So other people make these loans, and they are taking in some cases as much as 6% overrides for finding the loans.

And I'm just wondering, would a bank ever be allowed to be a facilitator like that where it simply shifts the loans to other buyers and takes a fee for finding the customer, underwriting a loan, and sending it along?

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Well, that's a great question. And we have -- every one of these, if you will, these technology-based lending solutions, whether it's peer-to-peer or whether it's just origination position, we've taken a hard look at every one of them. And I think it's a good question. Quite frankly, we've got a number of competitors who -- their rules of engagement are different than ours. And so today in our environment, some of that type of lending I just think we have to stay away from.

But that being said, there's still a lot of opportunity in that space. And we've got a team of really talented people that continue to look at it. We think innovation is a big part of how we bank the consumer going forward on both the deposit and the lending side. And some of these solutions



that you are seeing are going to play out and some of them are not. And it's our challenge to try to figure out who the winners and losers are in that space.

David Turner - *Regions Financial Corporation - Senior EVP and CFO*

You had mentioned really banking funding somebody else. What we would like to and are looking at is how those parties actually bring the customer to the table so that those are our customers, where we can have a deeper relationship than whatever that one-off loan is. So that really seems to be the better alternative versus being the funding agent, if you will, for somebody else's customers. But as Grayson mentioned, things are changing pretty rapidly. And we have to be able to adapt and deal with this on a prudent basis and obviously within the confines of our regulatory regime that we have.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

But a lot of financial products are moving out of the traditional banking space. And we've got to learn to compete with them but compete under the rules that we operate under.

Richard Bove - *Rafferty Capital Markets - Analyst*

Okay, thank you very much.

Grayson Hall - *Regions Financial Corporation - Chairman, President, and CEO*

Thank you. That's our last question. We appreciate everyone's participation, everyone's interest. And we will stand adjourned. Thank you.

Operator

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

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