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Regions Financial Corp. (RF)

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MANAGEMENT DISCUSSION SECTION

Erika Najarian
Analyst, Bank of America Merrill Lynch

Good afternoon, everybody. Thanks for joining us again. I'm really excited to have Regions Financial join us for this session. So with us today are Barb Godin, Chief Credit Officer; Ronnie Smith, Head of The Corporate Banking Group; and Deron Smithy, Treasurer, along with other members of the Management Team that will be around to take your questions during Q&A. And with that, thank you, all, so much for joining us today.

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QUESTION AND ANSWER SECTION

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

So Barb, I thought I'd kick it off with you. With the US election now behind us, who knows maybe, but COVID cases still spiking globally, can you kick it off by discussing your view and how the economic recovery will fare as we look out into 2021 and how important is a second stimulus and perhaps in an additional round of PPP to that recovery.

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.

A

Yeah. Let me start by saying we're really encouraged by the news that we all heard this morning of a vaccine [ph] we shall have (00:01:03) by the end of the month and potentially more than just one vaccine. So that would be great. Having said that, we still think we need a stimulus package that should come and again, we're hoping sometime in January timeframe that we would get a stimulus.

But having said that, we're encouraged already by a lot of the signs we're seeing, at least in the Southeast. And remember for the Southeast, what we saw is that the Southeast went into lockdown for COVID a lot later than a lot of the other parts of the country; and we came out a lot earlier. And you can look at things like around unemployment rate, which is about 200 basis points lower than the rest of the country, etcetera.

So things are starting to move along, which is good. We think that we're going to continue to have some rebounds but we think it's going to be up and down. There's going to be a lot of volatility, which is why we've talked about things peaking generally in the middle of next year, the middle of 2021 as we currently see it. So there's going to be continued stress, but there is some optimism clearly that's out there. And we think if shutdowns happen that they're going to be more targeted than be general in nature.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Got it. And, Ronnie, maybe just to get more specific, what are your 26,000 or so clients telling you about how they feel about economic trends are playing out in your core Southeast markets? And, how has that sentiment evolved over the past several months?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

Yeah. Erika, it really depends on which part of the industry that you talked to. As you can imagine, with 26,000 clients, you're representing a lot of the different entities. But if I had to sum that up, I would say cautiously optimistic. They're leaning really heavy into building cash. We continue to see that and pay down debt.

Capital markets has been strong, and so many of those who have access to the capital markets are taking advantage of the lower rates and paying down lines. We've seen lower line utilization as we reported at the end of the third quarter. We continue to see clients build cash. On the other side of the balance sheet, we're seeing unprecedented growth of deposits, especially the non-interest-bearing deposits.

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There was a bit of a wait and see about what would happen with the election, and I guess that has solidified a bit. There's some sense of maybe a little bit of uncertainty about what will happen, but I think that has moved them back a little closer to the center and [indiscernible] (00:03:48) just being as conservative as they have been in the past.

The things that you would imagine that are going strong are going strong. All material goods that are focused on the construction industry, especially home builder, is going very strong right now, essential goods, transportation that's associated with that, so anything that you think about also from a technology standpoint. If we were to talk to those clients, you would get a really positive view of where they are today. Others, I would put into the category of being more cautious.

And then on the other end of that, the volatility industries like oil and gas, restaurant, especially in the casual dining space but not quick serve. As a matter of fact, we're seeing some of the best quick serve numbers that we've seen in a while. So that's a bit of a waterfront answer but maybe get you a little bit of granularity into who we're talking and what they're saying at the same time.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Thank you for that. So, Ronnie, historically, management has talked about targeting loan growth in the GDP plus range. During your most recent earnings call, you did note that commercial line utilization levels have reached a historic low for around 41%. Can you talk to us about your expectation for utilization rates to rebound now that, perhaps, we have a vaccine that's effective and also the uncertainty of the election is mostly behind us? I guess the other way to ask this question is, what will get Corporates to move building liquidity and cutting costs to [indiscernible] (00:05:26)?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

Well, I think, when you feel like you have adequate liquidity, that will cause the pause. And most of the feedback that we're getting from clients is that they feel good about their liquidity build right now. So, we do anticipate that with utilization rates being where they are, we're forecasting, anticipating they will stay in that same area because our belief and what we hear back from clients is that they will plan to use their liquidity before they tap back into the line, so we do have some of that to burn through.

From a capital expenditure standpoint, I think they will want to understand, and again, what we're hearing back is that they want to understand what that will look like from an investment standpoint. Will there be incentives to do that and what will the future hold for them in their particular industry? So, I think that we will see utilization about where it is, bumping up and down, and we'll see some use of the cash build that has occurred before we see any dramatic movements back to higher line utilizations.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

And Ron, how has Regions benefited from some of the M&A disruption that we've seen in the Southeast so far? I mean if we could also get a little bit of an update on growth in your bench markets in Atlanta, Houston and Orlando, please.

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

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Yeah, sure. So, we have pulled out those as growth markets and they do represent great growth markets for us; and any time that there's disruption in the space, that creates opportunity for those of us who compete there. We've been successful of powering really strong leaders in all of those markets. We continue conversations about what those markets mean for us. But I would set aside the disruption piece of that maybe just for a minute and talk about longer view.

Obviously, disruption creates opportunity. But when we talk about attracting talent, it's really around taking a long view of who we are as Regions, building relationship banking, not focusing in on transactions and trying to be the long-term solution not only for the clients, but also for the associates that we're talking to as well. So in all three of those markets, certainly we're seeing good positive momentum, but we've got a long view for each of those markets as well.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Great. Another piece of the news, capital markets has had a strong year. It could outperform your initial revenue expectations of $45 million to $55 million and a quarter. Can you discuss some of the strategic expansion that has occurred in this business and where you see further opportunities? And what are your expectations for continued momentum in capital markets as we look out into 2021?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

Our capital market is a really solid story for us. As you know, we've built that out over the past 10 years. And it's been built to focus on our existing client base. And I think that may be the difference that you see when we are bringing in talent to that group. We're talking about the opportunity to penetrate a very broad, deep client base located throughout a 15-state footprint with the growth markets that you talked about just a bit earlier. This year, capital markets has surprised on the positive simply because we've seen interest rate at all-time lows and the company is large enough to utilize capital markets, have taken advantage of some of the long-term positions that they want to take relative to debt, paying down some of the lines that we talked about a little bit earlier.

M&A seems to be picking up a bit as we speak. There is more consolidation in certain industries that are going on. Although we haven't see the big rebound in M&A, we see green shoots, as I would describe it, for the M&A area. And I'd also think that do we need to build – I think your question was do we need to build additional opportunities or products and services. We feel good about the foundation that we put in place, but we certainly are always looking to do bolt-on type talent pieces that we could bring in and also products, especially around the fixed income side of things. So overall, very pleased with what we see within capital markets; and throughout the pandemic, it's been solid performance for us.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Thank you, Ronnie. Wanted to ask you about your RAROC [indiscernible] (00:10:36). I think in your Investor Day, you pointed out significant improvement of – it was 11% in 2016 and it went up 15% in 2018. Where does this settle out as we think about a lower for longer rate backdrop but post-pandemic?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

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Yeah. Certainly, rates are going to have an impact on the RAROC returns. But the way that we think about risk-adjusted returns is through the relationship. And so, we've put in place something that we refer to as our capital commitment working group.

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.
A

Yes.

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank
A

And that group is really focused on a weekly basis looking at the opportunities, material opportunities, that we have to do business with companies and ensuring that we're not doing transactions but that we have pathways to be relevant in those relationships, developing, if not traditional banking services, certainly capital markets and other ancillary business through our trust and private Wealth areas that help us to leverage that up.

Where does RAROC settle out post-pandemic? I think if I knew where rates would settle out post pandemic, I could answer that question a bit better. So I'm probably not willing to give a view of where we think that will settle out. What I will tell you is that we continue to see strength in relationships. We continue to see strength of funding. Our deposit balances have grown appreciably throughout the pandemic at a very low cost to us; and so all of that helps peel back those risk-adjusted returns that we're looking for.

Martha, I know that you've been involved from a RAROC and CCWG perspective for a while; and Erika may ask Martha if she has any additional comments about that topic.

Martha Raber
Executive Vice President & Head-Financial Risk, Regions Financial Corp.
A

Thank you, Ronnie. So I've been involved with it since we started CCWG, and it's truly become embedded in the organization as we think about how do we become even more meaningful to our clients, how do we optimize that relationship and make sure that we're providing them with the advice and the solutions and the product that they need. And CCWG is that forum that allows us to really have that discussion and talk through and challenge what are we doing, what should we be doing. And to Ronnie's point, we've been seeing the benefits over the year and it's really starting to snowball in terms of it's part of the DNA of all of our associates now.

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

By the way, CCWG stands capital commitment working group in case we didn't mention that.

Martha Raber
Executive Vice President & Head-Financial Risk, Regions Financial Corp.
A

Yeah. Right. We love our acronym.

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

Right. [indiscernible] (00:13:44) earlier. And maybe one more question for you, Ronnie, before I turn the spotlight back on to Barb. Non-bank financing has been a fierce competitor to your business.

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Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

Sure.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

And so many thought, including myself, that a recession would have helped [indiscernible] (00:14:01). But given the unprecedented amount of [indiscernible] (00:14:04) support, it doesn't seem like that clearing process is going to happen anytime soon. Any thoughts here in terms of how the non-banks evolve as competitors, and is there really anything other than REIT structurally going higher that would shake them out of [indiscernible] (00:14:24)?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

Yeah. I think, Erika, that our non-bank competitors are here to stay. I think they have found lower funding sources as well. There's a lot of liquidity in the market today. And so, I have not seen – with a few exceptions, I've not really seen a shakeout of the competitor set that we see in the non-bank areas. I do think that we've seen a bit of tightening by that group, simply because of some of the weakness that has surfaced throughout the pandemic and maybe some of the positions that were being taken have tightened, but not seeing that disappear, and I think that's another competitor that we will continue to have to face. We talk about our role as playing in that narrow space between the nationals and the smalls, and I would put the smalls along with majority of the time with that non-bank competitors.

And so, we have to be able to provide products and services that really outrun that particular set of non-bank competitors. And then, when we compete with the nationals, we have to out-service and out-relationship with our people with our belief and our philosophy that local banker [audio gap] (00:15:45-00:15:55) find the best is where we win the most. And so, we've competed effectively. We look forward to continuing to compete against both the non-bank and the bank competitors.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Thanks, Ronnie. And maybe just to piggyback off of some of the conversation regarding the capital commitment working group. Barb, Regions has gone through a capital optimization transformation, I would say, over the last couple of years. Among the many changes to strategy, it includes run-off of certain loan portfolios such as auto and GreenSky. Can you remind us of the loan growth strategy from here? Where are you looking to actively grow versus run-off and where do you see the most momentum as we look out into next year?

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.

A

Yeah. I'm going to start. I'm also going invite Ronnie to comment on that as well. And when we think about all of our portfolios, we're looking at relationships versus individual, single transactions. So, a lot of our focus is on that. And then as you think about GreenSky, as an example, or auto, those are individual relationships where it's hard to get the rest of that relationship. One of the things we found, Erika, is when you have the full customer relationship, your actual losses for that segment are lower than when you have single transactional relationships. So, it's good business.

On top of that, you can get in front of your customers and get in front of your businesses a whole lot sooner as well. And when you get in front of them, you're able to, again, to have those conversations with them in view of

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that entire relationship and know what else you need to talk about at the same time. So, we've been very focused on that whole piece of it and making sure, again, that those things that we do really well in our C&I and our Corporate space that we're continuing to focus on all of those as well. We've got a lot of specialties out there and a lot of expertise.

So with that, I'm going to ask Ronnie to step in because Ronnie runs that whole segment and he'll be able to talk a little more about that. Ronnie?

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

A

Yeah. Yeah. Thank you, Barb. I would just go back, Erika, and from a CCWG perspective, we're focused on what Barb said on the relationship side, but you will see us continue to rationalize capital, as we think about where we're going to utilize capital and open our balance sheet up to clients, again, staying away from the transaction type of relationships and looking forward to those that we're able to do build broad and deep in. And we will shape the portfolio as well over time. We've not been as active on the loan sales and trading desk, as I think you will see us, as we go in the future. And it takes a lot of discipline at this point to do that because loans are flat to down, just based on this whole issue around line utilization.

And so, – but it takes a lot of discipline to go out to secondary markets and shape the portfolio the way you want to. And we're driving that based on the concentration limits that we talked about a bit earlier, but we're also driving it based on the relationship returns that we're either seeing or not seeing. And so, CCWG represents the oversight group that will allow us to really focus in and to pick and choose the industries that will create this diversified portfolio we're looking for.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Thank you for that, Ronnie. And before I turn it over to a discussion on the credit quality outlook, I just want to remind the audience, if you have any questions for the Regions team that we have on, please remember to submit your question through the Vericast webcast portal.

So, Barb, during the third quarter call, you discussed expectations for net charge-offs to peak around mid-2021. Can you talk through the trends that inform your expectations for the pace of charge-offs and are you considering the potential for an additional round of stimulus?

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.

A

Well, as part of our reserving process, I'll let Anil talk to that in a few minutes, but we did not include stimulus in our reserving process. So I'll put that off to the side to begin with.

In terms of when we look at our charge-offs, we have looked with our customers' balance sheets and said, what do we expect from them both on the Consumer side as well as on the Corporate side. And that has helped inform us.

The other thing that helps inform us is all of the metrics, the early warning indicators that we have, etcetera, one of them is as simple as criticized loans, what's happening with our criticized loan levels. You can see in the third quarter our criticized loans were down. We're going to see some volatility and that. It's going to go up and down depending on what's happening up there. But that, to me, is that early bellwether that says, are things getting a

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little bit better or are they still – is there still a lot of stress out there. I don't want to lead you down the path of there is no stress. And if I sound too optimistic, it's not that I'm optimistic at all. It's, again, looking at every one of those signs.

Some of the signs, Erika, that I looked at on the Consumer side is things like residential mortgages. Are customers doing cash-out mortgage refis? Are people drawing down on their lines of credit and using that instead of cash, etcetera? The answer is, no; we haven't seen any of that. In fact, drawdowns and line usage is actually down from pre-COVID levels, which is surprising. So, what it means to me right now is what customers are doing is they've taken a stimulus they've gotten. They've also looked at their balance sheets which were – by the way, we're in the best shape ever coming into this recession. And they were able to say, what do we need to do to either trim our expense, in particular, the trimming of expense or to make sure we have any kind of additional cash coming in.

And consumers as well as businesses have done a great job on that front, on cash flow management, on liquidity, etcetera. So they haven't, for example, needed deferrals as much. We can talk about that as well. They haven't needed as many deferrals because of it. So we are seeing that things were getting a little bit better. They will be spotty. And we do believe, however, given all of that, given the stimulus, things will peak likely by mid next year before they start to get better.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

So before I ask you where you think that peak will settle out, maybe let's pick up on what you were referring to in terms of the deferrals. How have the trends been here in terms of the initial deferral period ending and then what is – once the initial deferral period ends and talk about the exit rate to current versus the need for a second deferral.

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.

A

Yeah. We have been really pleasantly surprised with the second deferral rates being as low as they were and have been showing us – we have not seen any tick up in the second deferral rate levels right now. So second deferrals we're running somewhere in that 2% level, which is great. Our customers, the conversations we're having with them, they are able to continue to make payments. We've seen very few that have had to come off deferrals and then actually go into charge-off for non-accrual or any of the other delinquency buckets.

So overall, so far and it's still early, fingers crossed, the things that things have worked well on the deferral front. But we are continuing to look at that on a day-to-day, month-to-month basis. It gets a lot of attention.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

And as a follow up to this, I think you guided for the fourth quarter for net charge-offs to fall between 55 basis points to 65 basis points. Interestingly, at your Investor Day almost two years ago, I think your expectations were 40 basis points to 65 basis points for 2020 and 2021; again, that's pre-pandemic. And how should we think about where net charge-offs peak? We fully get it. There's a lot of consensus from banks around the timing. But part of maybe the valuation disparity before today is that people are looking back historically. So what neighborhood do you think net charge-offs peak out for this cycle, given all the data that you have in front of you?

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Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.
A

I'm still back to the 40 basis points to 65 basis points, the original range we gave at Investor Day. We're consistent, if nothing else, and we really believe in our numbers and our analytics and our data and the way we service our customers, etcetera. Now, what you're going to see, having said that, is you're going to see some volatility just like you did at the beginning. In our second quarter, we had 80 basis points of charge off and then it went down to 50 basis points, as an example. You're going to see that kind of volatility. But on an annualized basis, the 40 basis points to 65 basis points is still a good range. So you might get a quarter that pops up somewhere sub 1% maybe. But beyond that, I can't see it.

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

That's quite a statement to make for the pandemic.

[indiscernible] (00:25:21)

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

Just to make it clear, it's not normalized. It's what you could see for 2021.

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.
A

That's right; what we could see.

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

So, again, leading levels of allowance for credit losses, especially when you exclude PPP. Now, many investors are starting to judge banks through the lens of normalized returns on tangible common equity or ROTCE. Under CECL, How quickly do we get to normalize reserve levels. And how do you define normalized reserves? And Barb, if you could just touch upon the RNS period or the reasonable and supportable period and how that may weigh into investors thinking as you go back to normalized reserves?

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.
A

Yeah. And what I'm going to do – by the way, our earnest period is 24 months. And what I'm going to do is turn it over to Anil Chadha. Anil, runs the seeker process for us. He runs the allowance process for us and analytics, a whole bunch of other stuff. And I'll let him get into some of the detail. How's that?

Anil Chadha
Executive Vice President & Head-Shared Risk Services & Analytics, Regions Bank
A

Thanks, Barb. Erika, So I think the best way to think about a normalized allowance level and the timeframe in which we get there is two primary lenses. You have to think about that through. One, we've already talked about, which is the timing of charge-offs. So clearly, and we believe we've set an appropriate allowance to cover the life of loan losses. So the real question is for those pandemic-related losses, when are they going to occur. And as we've said, we think they'd peak at mid-next year. We don't have a tail on them, especially depending upon what type of additional stimulus we get; that will determine how long the tail is. In terms of where do you think that

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ought to normalize to. Make a good starting point is to look at the day one allowance that we all set up and that was disclosed in each bank's 10-K. For us, that was about 1.7% of loans.

I think what's important to take into consideration there is you have to roll it out forward for the loan composition as well, right?

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

Yeah.

Anil Chadha
Executive Vice President & Head-Shared Risk Services & Analytics, Regions Bank

A

We talked about a couple of runoff portfolios. So if you break that down to individual loan allowance, which we have, then I think you can get that to be your normalized allowance level once you get through the pandemic-related losses.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

So I just wanted to dive into that a little bit. So are we misguiding into thinking that there is a "normal level" of reserves, similar to how there's not really a normal level of charge-offs, right? You're either in a recession or an expansion, right?

Anil Chadha
Executive Vice President & Head-Shared Risk Services & Analytics, Regions Bank

A

Yeah.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

So that's just [indiscernible] (00:27:57) average because from what we understand from the accounts, day one reflects a below-average charge-off outlook. So I guess the point is is that similar to charge-offs, should we expect reserve trends under CECL to sort of break through average and go right back to like you were saying, day one, and were reflected a better outlook.

Anil Chadha
Executive Vice President & Head-Shared Risk Services & Analytics, Regions Bank

A

Yeah. So I think what you have to take into consideration is in day one, we were expecting a fairly benign outlook over the two-year reasonable and supportable period. So in terms of what we revert back to post pandemic, our outlook at that period of time is going to be critically important as to what we expect losses will be. But ultimately, depending upon anyone's reasonable and supportable period, if it's one year, two year, three years, you get back through the cycle loss rate. So at any point in time wherever you are relative through the cycle loss rate, you could have your allowance above or below what you might say a normalized level is. But as you incur those losses, you're going to be within a range of what that is on a portfolio basis.

Erika Najarian
Analyst, Bank of America Merrill Lynch

Q

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Got it. Barb, when I I look into this this next question, I think about when we met 10 years ago that was quite a different time, 10 years ago at this time. And since then, you've just proactively and successfully managed your investor real estate portfolio under your watch. So as we think about potential structural [indiscernible] (00:29:27) demand for space, positive or negative, how should investors think about the length and magnitude of the loss cycle and inventor real estate for the industry and separately, how does regions outperform that?

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.
A

Yeah, and I'll start. I'm also going to invite Ronnie. Again, that's one of Ronnie's portfolios and I think he can add a lot of value here. We talk about our book to begin with. We have very successfully an investor real estate, concentrated on making sure that we have a very well diversified book. Client selectivity has been absolutely paramount. We focused on the owners. We focused on making sure that they have the equity to withstand any kind of a stress. And that all feeds into the quality of what you're going to put on your books. We also look to something called hard equity. So how much cash do they have in the deal, when we underwrite that deal which is really important.

We typically don't do much more than a 65% loan-to-cost relative to any of our projects, which is great. And there's a lot of lessons that came out of that Great Recession. And the biggest one and the one that we continue to believe in is diversity, diversity, diversity. And even within the investor real estate portfolio. A lot of diversity making sure we have no outsized credit exposures on anything. But let me ask Ronnie – invite Ronnie to make a couple of comments on that.

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank
A

Yeah. Barb, I don't think I can add anything to that. Erika, those are the principles that we lean into from a real estate perspective, we do look for – Barb mentioned diversity. We do look for diversity not only by industry but by geography as well. We did learn some lessons through the Great Recession about too much concentration in a couple of Florida and maybe Georgia markets. But we'd look – we'd try to slice and dice that real estate portfolio as much as possible

And for all of you that have our numbers, you realize that we do not have an outsized balance against the rest of our loans relative to real estate. We have the ability to grow but we also are seeing those borrowers take advantage of the capital markets that we've talked about a little bit earlier. And so that, again, helps create good solutions for them and it refreshes our portfolio and allows us to book for whatever the challenge is right ahead of us. But, Barb, you did a great job of answering that. I can't add much more to that.

C. Matthew Lusco
Senior Executive Vice President & Chief Risk Officer, Regions Financial Corp.
A

Barb, I will add on top to that. I think one of the key differences for us when looking forward to is the investment we've made in people. I think, since the time of the Great Recession, we've continued to add to – our risk management team have added broader and different credit skills such as Anil and Martha that are part of it. So you've been part of the success. Responding to this has been very effective recruiting of which you deserve a lot of credit for that in terms of broadening and building and deepening our credit skills, as well as ensuring that we've got those embedded within the first line of defense, too. So, we're a lot broader and deeper team as well.

Erika Najarian
Analyst, Bank of America Merrill Lynch
Q

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Thank you for that. I wanted to shift the spotlight to Deron. It wouldn't be a Regions fireside chat without a discussion on net interest income and net interest margin. That being said, I think, you and David deserve a lot of credit. The stock has greatly benefited from the strategy of opportunistically adding about $22 billion of forward-starting hedges before the pandemic. They're expected to provide about $95 million to $100 million of net interest income per quarter for the next several quarters. Can you discuss how your hedging strategy has evolved and whom do expect this protection to benefit [indiscernible] (00:33:33) revenue and remind us also please, if you could just [indiscernible] (00:33:37), just how much of a boost this gives your NIM in 2021 and 2022.

Deron Smithy
Executive Vice President & Treasurer, Regions Bank

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Yeah, sure. So the hedging strategy was really designed to just protect against what would be an eventual downturn in the economy and declining rates. Obviously, we didn't expect it to be as dramatic as what we're experiencing now. But the hedges are truly hedges. They're designed to protect us in what is our most vulnerable environment, which is an extremely low rate environment. And so, as we think about how they evolve or how they contribute to next year, it does help us to contribute as much as $400 million next year to earnings, which is a pretty big boost to us. It helps us to stabilize net interest income.

Obviously, we still have the ongoing repricing of the balance sheet for loans, fixed rate loans and securities that are coming on at lower rates than what is rolling off, and that will be a persistent headwind for us, but that will play out over time. What the hedging has allowed us to do is to not really have much of an impact from changing short-term rates and certainly coupled with our deposit rate management strategy.

And so, short-term rates are covered. We'll have the longer-term impact from a repricing balance sheet. We're certainly optimistic to see a steepening in the yield curve today, which helps reinvestment rates and prepayments and securities and such. But again, I think the hedges have just helped to stabilize net interest income looking forward. And so, as we now turn to what is hopefully a continued improving economy and we start to see loan demand over time return, it'll help us be in a position to grow net interest income from here.

Erika Najarian
Analyst, Bank of America Merrill Lynch

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So I'm glad you brought up and answered the question the way you did, because this may not have been a question two weeks ago, but obviously, the yield curve is steepening. And if we see the kind of spending that we're expecting for next year, whether it's second stimulus or infrastructure – and infrastructure, we could see further steepening. Just wanted to clarify and emphasize that the protection that you have currently is for short rates, which the Fed seems to be committed to keeping where they are, keeping at zero. But you haven't essentially given up your "upside" the shape of the curve, the long and [ph] continued rise (00:36:17), steepening the yield curve that way.

Deron Smithy
Executive Vice President & Treasurer, Regions Bank

A

That's correct. This environment, the way we're positioned with the hedges, as well as how we've managed deposit cost down. We've somewhat neutralized the impact of short rates. But a steeper curve allows us to benefit over time as our balance sheet reprices and new assets come on the books. So this steepening environment is the most beneficial environment for us to grow net interest income over time.

Erika Najarian
Analyst, Bank of America Merrill Lynch

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Deron, Ronnie earlier talked about the abundance of liquidity, that Corporate clients have and Consumers also have it. How should we think about the duration of some of the excess deposit growth that you've seen year-to-date? And what signs would you have to see to more aggressively deploy some of your excess cash into something with a little bit more duration?

Deron Smithy
Executive Vice President & Treasurer, Regions Bank

A

Sure. As Ronnie mentioned, a lot of the growth that we've seen is coming in operating accounts and it's coming in non-interest-bearing which is obviously our longest duration deposit category. And so as such, we've seen an opportunity to put some of that to work incrementally in securities although I would tell you that's not our favorite way to put it to work.

We've also reduced a lot of funding expense. We have virtually no wholesale funding outstanding. So as we – and we've tried to answer – and certainly the questions you're asking about how long will these deposits stay with us, and I think it's a mixed bag. I think as the economy continues to improve. As Ronnie said, customers will take their excess liquidity and put it to work first either productively in growing their business or before they seek incremental credit.

So I think over time, you'll see some of that leave our balance sheet and get put to work, but I think we've continue to grow customers and grow operating accounts. And so I think some of it will be with us persistently. And hopefully, we'll be able to put that to work over time through loan growth, but I think given the steepening of the curve, we may see opportunities to incrementally add to the securities portfolio as well. We'll watch that closely. It won't be anything dramatic, but I think we could add incrementally to the portfolio.

Erika Najarian
Analyst, Bank of America Merrill Lynch

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Great. And the final question for me and I'm going to look at the audience queue questions, Deron, how are you balancing digital and other investments against producing positive operating leverage in a difficult revenue environment? Are there enough cost savings identified that can help the bank generate positive operating leverage next year?

Deron Smithy
Executive Vice President & Treasurer, Regions Bank

A

So I think the way you should think about it, we've been very active and we've done a great job of managing expenses over the last several years to being roughly flat.

That is our goal to continue, obviously, we still have to make continued investments in the future and we through the – look, we started as simplifying growth and now has evolved to continuous improvement. We've been able to find ways to be more efficient in how we execute our business while making banking easier for our clients and improving the customer experience. And we're using digital to improve our efficiency internally but also to give us incremental revenue opportunities. And so we're certainly committed to positive operating leverage over time.

But as you point out in this challenged revenue environment, doing so in 2021 is going to be a real challenge. Not saying we're throwing in the towel on that but the math is just a challenge there. But at the end of the day, we have to continue to find ways to operate more efficiently while meeting customer demands, so that we can continue to invest in digital. We've talked about our spend from a technology standpoint is being more than $600

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million annually and we've been able to put 40-plus percent of that to work and things that we consider offensive. And again, improving the customer experience and making banking easier.

And so we'll continue to look for those opportunities. We're focusing on those things that we think can provide us near-term benefits to clients, but we have to keep finding ways to become more efficient, so that we can continue to do that; but we are committed to continuing to making those investments in technology.

Erika Najarian
Analyst, Bank of America Merrill Lynch

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Got it. We have a follow-up question here. Maybe we just have time for one from the audience. I think this is for both Ronnie and Barb. You've been a leader in the energy lending business for over 50 years. But having managing down your portfolio. Discuss how are the conversations with your clients had gone when considering a Biden administration.

Ronald G. Smith
Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

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Barb, you – Yeah. So, Erika, we are in the energy business and intend to stay in the energy business just foundationally. We do have conversations with our clients about any changes of policy that might occur. But I would just remind that it's an industry that we'd been in for 50 years. There have been multiple policies that have occurred. In the 30-plus years that I've been doing this business, we've seen a lot of ups and downs in that industry. It's very volatile, but we believe that utilizing very conservative underwriting from a risk standpoint and seeing clients adapt to what the future holds are the clients that we're really focused on and developing long-term relationships with.

There's a real push for clean energy. And candidly, gas happens to be one of those clean energy fuels that powers plants that produce electricity. And so, as I look at the industry today, I do think there's opportunity for them to work with whatever policy changes that may come about, providing less emissions and more solutions to the initiatives that are in place. These are companies that, as I said, have been through several different changes and ups and downs throughout.

The last thing that I would mention just from a risk standpoint is that they can be contributors to the rebound of the economy. If you see where oil and gas and specifically crude is trading today, you have to think about that without a whole lot of airline usage. And so, there's not been a great solution on the airline industry for anything other than jet fuel. And so, as we see the economy rebound, we'll see demand pick up. Additionally, as a percentage, this is not the highest – one of the highest rig count lay downs that we've ever seen. And so, there's not a whole lot of exploration that's going on relative to where we were pre-pandemic, and sooner or later, the law of supply and demand really comes back into play in a big way.

So, Barb, maybe too much there, but I'm happy to hand it over to you for any additional comments you may have.

Barbara I. Godin
Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.

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Well, I think you've covered it really well. And given the time constraints, I think it's perfect.

Erika Najarian
Analyst, Bank of America Merrill Lynch

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Great. Well, thank you, everybody. I think that's all the time we have for this session. I know you brought a strong team together to discuss it with investors. And Barb, I wish you just the best in your retirement.

Barbara I. Godin

Senior Executive Vice President, Deputy Chief Risk Officer and Chief Credit Officer, Regions Financial Corp.

Thank you so much. Really appreciate it. Going to miss everybody.

Erika Najarian

Analyst, Bank of America Merrill Lynch

All right. Thanks, everybody.

Ronald G. Smith

Senior Executive Vice President & Head of Corporate Banking Group, Regions Bank

Thanks, Erika.

Deron Smithy

Executive Vice President & Treasurer, Regions Bank

Thank you.

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