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M. Deron Smithy
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Senior EVP & Head of Corporate Banking Group

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Gerard Sean Cassidy
RBC Capital Markets, Research Division

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Presentation

Gerard Sean Cassidy
RBC Capital Markets, Research Division

We'd like to get started with our next fireside chat. Many of you know Regions Financial. Regions is -- has over $155 billion in total assets and market cap of $22 billion. Price to book on an adjusted basis backing out AOCI trades at about 1.3x book as well as 2x tangible book. Joining us today from Regions to my immediate left is David Turner, Chief Financial Officer. David joined Regions back in 2005. To his immediate left, Deron Smithy is the Treasurer, and he's been in this role for a number of years, and he joined Regions back in 2008. And then to Deron's left is Ronnie Smith, Head of Corporate Banking; and Ronnie joined way back as a trainee like myself in the early '80s, I won't give the year. And has held the current position since 2018. So gentlemen, thank you very much for joining us.

David Jackson Turner
Senior EVP & CFO
Of course.

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Question and Answer

Gerard Sean Cassidy
RBC Capital Markets, Research Division

Maybe we could start off with a macro question. David and Ronnie since you do a lot of work with the corporates in your market, just what's your outlook for the economy. There's so many crosscurrents that we're seeing. You look at the inverted yield curves. But on the other hand, you look at employment and it's quite strong. Headline in today's Wall Street Journal, more women coming back into the workforce, lifting up the economy. So what are you guys seeing down -- the footprint down in the Southeast?

David Jackson Turner
Senior EVP & CFO

Yes. So thanks for having us. I'll start and Ronnie and Deron can add to it. But we're feeling pretty good about the economy. We had and still do forecast a slowing economy, but not a recession. Our base case is right at 1% GDP for the year. We have some nuances in the quarter, but slow growth and frankly, the difference on things like credit quality should we have a slight recession versus a slowing growth is really negligible. So if we go [indiscernible] it wouldn't be all that surprising.

Our footprint continues to have one of the lowest unemployment rates. We were late to slow our business down because of the pandemic, we reopened earlier, and we've seen quite a lot of migration of people coming into our footprint, Florida, Texas, some in Georgia, Tennessee taking advantage in part to no state taxes. But we look at our accounts, customer by customer, account by account and our consumers have a lot of cash in their account.

Businesses are strong. And so we might not see a lot of growth. Clearly, the Fed is trying to slow inflation down and they're going to keep going until they feel like they have it under control. So it will have an effect to slow the economy down. But it may take some time because of the resilience of tough consumers and businesses alike. So all in all, we feel pretty good about the year. We do think the Fed has changed policy, you'll have probably a later question in terms of rates. We'll talked about that. But net-net, we feel pretty good. But Ronnie, you want to add?

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes, Gerard. You hear labor, which is kind of the common theme that we hear, not just from large corporates, but across all businesses. If you ask what is the #1 challenge that they have that's struggling to grow their business, it's skilled labor and labor in the right places. And so we hear that over and over again. Supply chain at a macro level as well is better, but not repaired completely. You can find certain sectors within the businesses that we do business with, they are really struggling on delivery dates and still years out on heavy equipment and really replacement of machinery that they need to handle, and there's still interruption in the supply chain that is occurring as well.

They're overall concerned about inflationary pressures. But the majority of our companies report that they are able to pass along at this point, the rising cost to either their consumer or to the businesses that they do business with. So there is some consistency but also very cautious about how much longer that they will be able to pass just increasing cost. And of course, rates, that's the other thing that we hear from companies today. How high will rates go, and that's an added expense that they did not have a couple of years ago. And so those are the concerns.

To David's point though, I'll just reiterate this. We say our business is building more cash. They're really focused on if we can't buy inventory and have it just in time, even solutions, we do see them laying back into building cash balances and preparing for whatever storms may be ahead as we move into '23 and beyond.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

And David touched on this in his comments about your part of the country came out of the pandemic faster. They seem to open up quicker. Many companies became lean and mean, I think, during that period because we really didn't know for 6 months how bad it was going to be. Do you guys see that you're -- when you talk to your corporate customers, that they just seem to be stronger or better than 10 or 15 years...

David Jackson Turner
Senior EVP & CFO

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They're much more efficient. So they had their hand forced to become a lot more efficient depending on new processes, new delivery types. They continue to focus on that on a go-forward basis. But there's just so much of a runway that you can put in place to create that kind of efficiency, it becomes more tweaks rather than overhauls that we saw during the height of the pandemic.

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

And I would just add, I think, and it's really important you see it in our stability of the deposit base. They've become more liquid through that period, and they're maintaining higher levels of liquidity. Yes.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

Speaking of deposits, I always reference your slide in your slide deck, I think it's Slide 18, where you show the deposit trends of the lower deposited types of customers against your delinquencies. And it's very impressive how the deposits remain elevated on the consumer side. Can you share with us some of your thoughts on what you're seeing on the consumer side in terms of the balances?

David Jackson Turner
Senior EVP & CFO

Yes. So broadly speaking, consumer balances, and it's on a different slide than that one, I'll come back to that one, actually have grown year-over-year. It's been the business services, Ronnie's deposits that have declined as expected. And the consumer, if you go back to why is that or how do they have that much cash, in particular, the slide you're referring to, the lower balance customer today have 6x more cash in their account than they did pre-pandemic.

So we can mine that data customer by customer. And as we think about how can that be, especially with inflation and all the costs, well, they were also the recipients of most of the stimulus and still getting stimulus in some form or they were recipients of minimum wage increases. Those don't go away, so they've reset their earnings. And if you look at the area of the country where we are, we're in smaller markets than major metros.

And so that has been a big benefit to us. We have more noninterest-bearing accounts in part because of where we bank. It's just that's our competitive advantage. We've talked about for many, many years. You just don't see value of that until you have a rate environment like we do today. But you want to add to that?

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes, I would just reiterate the point that we've studied it over a number of years, and it is interesting that -- and this is true for our median customer as well. But particularly in the small balance customers, they've seen wage increases that have kept pace with inflation, if not a little better. And they built liquidity, whether it was through rescue payments or stimulus payments and they've held on to that. So as we enter what is in front of us, they're in a much better position to manage through what is to come.

M. Deron Smithy
Executive VP & Treasurer

One other point, David and I've made is that small businesses, medium, large corporates are all building more cash. So it's a little bit counterintuitive for us to say that we're seeing a big shift out of the corporate deposits. I probably would like to point out that there is additional use of dollars going back into an unmentioned inventory purchases, which drive receivables uses up cash. So we have seen a shift down, but we also measure liquidity held by our depositors, not only what's on our balance sheet, but what we're able to sweep off balance sheet as they look for higher rates than what we're willing to pay.

So if you look at the peak of where we were during the height of the pandemic and the surge deposits here, we are only down about 10% in what we consider to be total liquidity under management. So I don't want that to come across as you're saying they're building cash, but you're also seeing declines. They're putting their money to work where they can get the most return, that's with their business. The second place they're putting their money to work is with some off balance sheet options, we get fee-based revenue off of that. But they're working their dollars harder as it's become more meaningful. But overall, more liquidity sits at the business level than what we've seen historically and certainly pre-pandemic.

David Jackson Turner
Senior EVP & CFO

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And I'll put a final point. So if you look at our material, we're calling for our deposits to decline this year $3 billion to $5 billion. And we would see that during the first half of the year and then it stabilizes and maybe we grow a little bit from there. That $3 billion to $5 billion is what Ronnie is talking about companies putting it to work, maybe wanting a higher rate than we're willing to pay, but we can move that off balance sheet. We get paid a fee to do that. And if we need that, all we have to do is pay a little bit more if we can get that back. So it's another source of liquidity for us. We don't have wholesale borrowings. We don't expect to have that until perhaps this summer, and that's all going to be dependent on loan growth.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

And coming back to the lower denominated deposits, do you find that those are very sticky and they're not the first to leave on a 100 basis point increase in rates versus a large denominated deposit of $300,000?

David Jackson Turner
Senior EVP & CFO

Yes. So we have higher primacy than most banks. That is, our customers look to us as their primary bank. Money goes in, money goes out every month. If you can look on one of the slides, we show you the number of accounts in our portfolio that are less than $250,000. We have more than everybody else. And it's again where we happen to operate. Yes, we're in major metros, but we're in a lot of tertiary and secondary markets where there's just a lot of pricing sensitivity, a lot of noninterest bearing. So our noninterest-bearing percentage today is 39% of our deposit base. We've always had a high level, not that high, but I think we're at 29 or 30 in normal times. So that's a big funding advantage for us.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

Absolutely, absolutely. You touched on what you expect for deposits this year. Maybe, David, you gave us guidance in January about the quarter and also for the full year. Is there any updates you would like to add to what you guys said?

David Jackson Turner
Senior EVP & CFO

So we gave an increase in NII of 1% to 3% for the quarter. I think that, that's intact. I think we're 13% to 15% for the year. Clearly, rates are higher. The curve is higher today than -- I think it was a cut that was baked into the curve right at the end of the year is probably not going to happen. So we still think that range is appropriate. Perhaps we end up at the higher end of the range. We'll see what happens, but I feel good about that.

Our expense increase was 4.5% to 5.5%. We still think that's a good annual number. Now you're going to see some quarterly changes. We tried to give you a little bit of a heads up on the first quarter because we changed our merit increase to start in the first quarter versus the second, of course, we have payroll taxes. So our first quarter number will be higher. If you try to annualize that, you're going to get a bad answer. So do that at your own peril. But I think that we feel good about the revenue. Revenue is going to be up 8% to 10%. So that generates positive operating leverage of about 4% and we feel good about that.

And then credit is 25 to 35 basis points for the year. We still believe that's the right number. You can have in any given quarter, a number outside of that. Just got to be careful, there's some -- from time to time, we'll have an idiosyncratic charge off a large credit if something happens. But as we look at our portfolio and talk to our relationship managers who all work for Ronnie, we feel good about the 25 to 35 charge-off range.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

Just sticking with credit for a moment and Ronnie, you probably have seen this more in Europe part of the bank, but Regions has really derisked the balance sheet over the last 15 years. And so when you look at credit going forward, obviously, I shouldn't say obviously, you're probably going to outperform what happened in the recent past in '08, '09. But where -- are there any spaces that you do kind of keep extra attention to, whether it's construction loans or leverage loans, anything like that?

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes. So certainly, leverage loans carry more risk that's associated with it. And we reserve leverage lending for those deep relationships that we have. It's not a strategic play for us. But any time there's more debt on the company's balance sheet, there's more risk that is

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associated with it as well. There are a couple of other sectors, though, that we're certainly paying close attention to, office, and I'm sure that all of you have talked about before, there's been certainly a change in how we think about office on a go-forward basis.

Certain areas that sit within our health care world, specifically around technology and some of the senior care also has faced pressures throughout the past year, although we've seen some stability in that sector, we still are keeping a real close eye. But those are a few. On the lower end of transportation, single freight operators, we've -- as there have been changes in last mile delivery, we've seen more pressure in that particular space.

And that really has more of an impact on our small business book than any of the large corporates within the freight and transportation area. But those -- George, those are a few. When I get asked that question and someone says, what are you looking at? Everything. There's a lot of fast-moving changes in this economy, but those are ones that we probably have more of a hyper focus on.

David Jackson Turner
Senior EVP & CFO

A couple of things I'll add to that. So our leverage book is a little over $3 billion, and so not all that large. And I think 90-something-percent of that 90 -- 30% of that's in the Shared National Credit book, too. You had mentioned going back to the crisis '08, '09, and you said we ought to perform better. We -- yes, we will perform better, substantially better. So I mentioned 25 to 35 for this year, that's not back to "normal" because of what we just talked about, the strength of the consumer and businesses.

So we think based on our risk profile that our normalized charge-off rate is 35 to 45 basis points. When we get there, who knows, and again, it goes back to what's going to happen in the economy. We just don't see how that can happen this year. There's just too much cash sitting and consumer checking accounts and operating accounts for businesses.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

One of the questions we've been asking your peers is from your guys' opinion, you obviously experienced bankers. And I go back to '94, '95 and the Federal Reserve took the Fed funds rate from 3% to 6% in 12 months. Orange County, California went bankrupt. Mexico was a mess. We had Wall Street derivative disasters. So far, I mean, we've gone from 0 to 4-3/4, and soon to be 5. And we haven't seen any will other than the U.K. pension issue, which is resolved. Do you guys have any time, and we're not out of the -- I'm not suggesting we're going to make it out of the woods without a disaster, but any sense of why it hasn't been as disruptive as what we've seen in the past?

David Jackson Turner
Senior EVP & CFO

So part of it is we're absolutely still lower though than the 3% to 6%. And when you come out of a crisis, you learn a few things on what to do and not to do. And I think businesses are just run better. I think consumers are -- in general they're more frugal, they pay attention, they put money away for the rainy day. Today, they don't live as much as levered as perhaps they were.

And if they are levered, and so we see a lot of leverage in the system, but it's fairly cheap if you talk about fixed rate mortgages and things. Now today, the mortgage rate is pretty high. But if you look at what's in the portfolios, it's really low. So lot of value in homes and things of that nature. But I just think it's a different environment all around.

Ronald G. Smith
Senior EVP & Head of Corporate Banking Group

Yes. I would just add that there's still a lot of liquidity in the system. A lot of liquidity has been built in the pandemic period and much of it still remains on corporate balance sheets as well as consumers as we talked about. And so I think it is businesses being more efficient through the pandemic period, being better prepared liquidity as well as it's been pretty well telegraphed.

Now I think we're likely getting to interest rate levels that are higher than we might have thought. But I think the market was prepared for rates need to move higher. And I think Fed has done a good job in communicating that. And so I think all of those things together, I think one of the things David mentioned also is, even though we're in a higher rate environment now, there was an extended period of low rates where consumers were really able to term out debt at really low levels, especially the mortgage debt, which is likely the largest single fixed payment that consumers have. And they've been able to take advantage of really low rates and lock in those long-term low rates, which has helped their cash flow. So I think it's a combination of all of those things. But really, I think the liquidity in the system so far is what's really helping.

David Jackson Turner

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Senior EVP & CFO

I want to try an analogy on the group to see it resonates. But what the Fed is trying to do is think about approaching a stop sign in a car. As you get -- when you first start to brake, you hit your brake pretty hard. But as you get closer to the stop sign, if you know how to drive, you ease up on the brake. So you don't -- you save yourself when you stop.

And that's what they're trying to do with interest rates. So they were braking hard early on and they're trying to back off a little bit. The problem is the point Deron is making is, they have their left foot on the accelerator at the same time and that accelerator is liquidity. So the liquidity in the system is working against what they're trying to do, not to mention supply issues with energy and things of that nature that we could talk a lot about. So there's so many things at play here is making it hard for them to get inflation under control.

So the question that we get asked all the time is how far are they going to go? We don't know. But we know this, they're going to keep going until they get it under control. And if that's the message I think that the Chairman is trying to send, I think he did a pretty good job to send that message to everybody whether you like it or not and get this thing under control and go pretty hard.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

Speaking of interest rates, maybe, David, you could share with us your hedging strategy, you've been using this quite actively over the last 2, 3, 4 years, quite successfully. And maybe just talk to us what you're doing now, how you're positioned for these higher rates?

David Jackson Turner
Senior EVP & CFO

So it's Deron's baby, so I'm going to let him talk about it. Well, I think that strategy has to start with an understanding that our balance sheet naturally benefits from higher rates. And so the flip side is true as well when rates are low, that's where the value of the deposit base, we're not able to distract -- extract the value out of having that very sticky, low-cost core deposit base.

And so our hedging has really been designed over the last several years to help us manage through those low -- and protect those low-rate environments, but give us an opportunity to now begin to see the true value of the deposit base emerge as we get to more normalized rates. And so again, it's an ongoing strategy, understanding how our balance sheet is evolving. As we sit here today, we're still modestly asset sensitive. We have been protecting the potential downturn more on the horizon, not in the very near term.

And so we've been adding protection that some of that starts in late '23 and continues into '24 and covers the period from '24 through '26. And we're really comfortable with that position today. We've messaged that we're roughly 75% hedged. And there's still a lot of uncertainty as to how far rates have to go, how long they have to stay there. And then ultimately, what plays out on the deposit front -- we think we have some reasonable assumptions. We're expecting higher betas than last time, last cycle, just simply because we're going to be at an absolute higher rate level and likely stay there for a little longer.

We've positioned the balance sheet to be modestly asset sensitive, which gives us some added flexibility if the Fed has to go farther and we stayed there longer that we're still going to have stability in the margin. But our attention is really looking further out on the horizon and thinking about that environment where the Fed goes back to neutral because they've been successful with dealing with inflation or the weight of higher rates rolls over the economy, and they have to go to a more accommodative position.

So that's where our focus is. Again, we feel pretty good about the protection we have in place over the next 3 years, but we are adding to positions out '26 and beyond. And despite the shape of the yield curve, we're still seeing levels that we can put protection on that are really attractive, better than 3% receive rates on 3 or 4-year swaps. And so we think that's a pretty attractive level because even if the Fed goes back to neutral, and none of us know exactly where neutral is, but 2.5% to 3.5%, somewhere in that range, those swaps are going to be there to protect us if they need to go lower. They're not going to present much of a headwind if we're back to neutral rates.

And that's out on the horizon where we think what we're going through now will have largely played out several years in advance -- several years out on the horizon. But still know that our exposure is to low rates, and we think these are very attractive levels to protect that downside. So this is really important. These hedges are not trades. We're not trying to make money here. It's protection for the low rate environment. So when you have a low-cost deposit base like we do, we don't have a mechanism to protect us when rates are low, we have to do it synthetically through the use of derivatives. We do these on a forward starting basis.

So Deron mentioned quickly there. We have some of these going on in the middle of this year, and they take us out a number of years. So we can, at some point, get into a negative carry. And we're okay with that because what we've done is to position ourselves to have nice returns on tangible common equity. And it's all the other things that we've done to manage our business, expense management is

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a great example. When we can get a return -- so our return last quarter, I think, was 3%. Now that's got OCI, the crazy accounting and helps the denominator.

But even if you strip that out, it's high. And that's not normal for a regional bank to have. So when we can get the kind of returns that put us in the top quartile of our peer group, it allows us to be able to give up a little bit of margin that we could have gotten had we not had the derivatives. But again, we're not trying to top-tick the margin, we're trying to protect ourselves when rates eventually go the other way. If we're wrong and rates go to 5, 6 and stay there for an extended period of time, we're okay with that. It doesn't hurt our feelings at all. Now betas will start catching up, but we'll still make a lot of money.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

That's very good, very clear. You mentioned accounting, crazy accounting. And one of the areas I know you and I enjoy talking about is CECL, which is different than AOCI but in the same ballpark. The -- we're hearing that so far, and it's only in February, and I know you guys will get another Moody's outlook in March, but we don't seem to be seeing the deterioration that we saw 2, 3 and 4 last year. So maybe what's your thoughts about just reserving if the Moody's outlook stabilizes?

David Jackson Turner
Senior EVP & CFO

Yes. So we do our own shocks. We do look at Moody's as well, and we come up with a scenario that we use to base our allowance on. We have a pretty robust allowance in the year of $163 million. And that has unemployment baked into it, I think, in the mid-4s, right at 4.5%, 4.4%, I think, pretty tough on housing and things like that, unemployment, other things that cause us to have robust reserves.

We see right now that the additions to the reserves, if any, will be primarily driven by loan growth and whatever we have. So we forecast 4% loan growth for the year. And we got [bribed] unfortunately. When you book a loan, you got to have life along losses at day 1. Makes no sense, but that's the rule. We got to abide by it. So I don't see the deterioration in the economic environment right now, but that's what we remeasure every quarter. And if we see it changing, then we'll adjust the reserves accordingly at that point in time.

Gerard Sean Cassidy
RBC Capital Markets, Research Division

Yes. When you look at capital and the CET1 ratio, of course, is the binding constraint, maybe you can refresh us what your targets are for CET1. And then just how you approach distributing your earnings every year or your excess capital?

David Jackson Turner
Senior EVP & CFO

Yes. So we have an operating range of 9.25% to 9.75%. As a category 4 bank, we don't include -- don't have to include the OCI component and regulatory capital. And that's why we don't care about OCI and what that does to us because it's driven by change in interest rates. So as we think about capital, we're going to generate a lot of capital. We want to put that first and foremost work to support our balance sheet growth.

Second, we want to pay a fair dividend to our shareholders. We've targeted 35% to 45% of earnings for that. And that range is determined based on stress. And we want to be able to maintain that dividend in the case something really bad happens and now we have been at the lower end of that. But I think our dividend increase last time was about 18%. So we've been increasing it quite nicely. And fortunately, earnings keep growing faster because of the rate environment and all the things we just talked about.

So we really would like to put the capital over and above those 2 things to work in nonbank acquisitions. So we had, in '21, a lot of activity. It has worked out well for us. None of them did we bet the farm on, and those are the kinds of things we have our M&A team that will sit down with our segment leaders. Ronnie is on the corporate commercial segment leader and a wealth leader and a consumer leader to talk about products and services that they may not have or that they want to expand that can help our customer base. And so we're out there looking all the time.

Bank acquisitions are really not something that we're looking at right this minute, and I think that's played out well for us. And so being a little patient and being able to put that capital to work with the nonbank acquisitions are first foremost our priority. If we can't put it to work, then we'll buy our shares back because we want to be in that operating race, and we said we'd be at the upper end of that range, primarily because there is some uncertainty out there. And frankly, 25 basis points of capital for us and the impact to our return is negligible. So we're okay having a little bit more capital today.

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Gerard Sean Cassidy
RBC Capital Markets, Research Division

David, I know you're not interested in depository acquisitions. In years past, you guys obviously have done some. Can you -- just your view of why has it taken so long -- not specific deals, but just the regulatory process is brutal it seems like to get deals done. Any thoughts on the way you view it?

David Jackson Turner
Senior EVP & CFO

Well, I think there are still several that are going on right now that have been out there for quite some time. We don't know the fact of any given deal. What we do know, and this is talking directly with regulatory supervisors where they'd be -- ones in Atlanta or Washington that -- the profit is just taking longer. And you've got community groups that are involved big time. And you could see some of the commitments to the communities. To work all of that through the system does take time.

And you can see when the filings are made, all the thoughts that went in there, whether it be for each of the companies or the regulatory supervisors, it's just -- I think they want to be pretty thorough, and we can debate how thorough one needs to be, but we don't see that changing. And as a result, there are risks to entering into a depository transaction from any -- anything of size because you put the company being acquired at real risk of their customer base and their people just saying, I don't know if I want to hang out here. I need some certainty. Uncertainty for anybody is a bad idea.

That's what I wish we would get is a little bit more clarity. We need to take the proper time to do the proper things, but let us know how long it's going to take, and then we can adapt and overcome. But when you don't know, when you're just sitting idle, it's pretty hard.

Gerard Sean Cassidy
RBC Capital Markets, Research Division
Yes. I've noticed the red lights going off. So I want to thank all 3 of these gentlemen for joining us. Please join me in a round of applause for these gentlemen. Thank you.

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