

# Regions Financial Corporation NYSE:RF

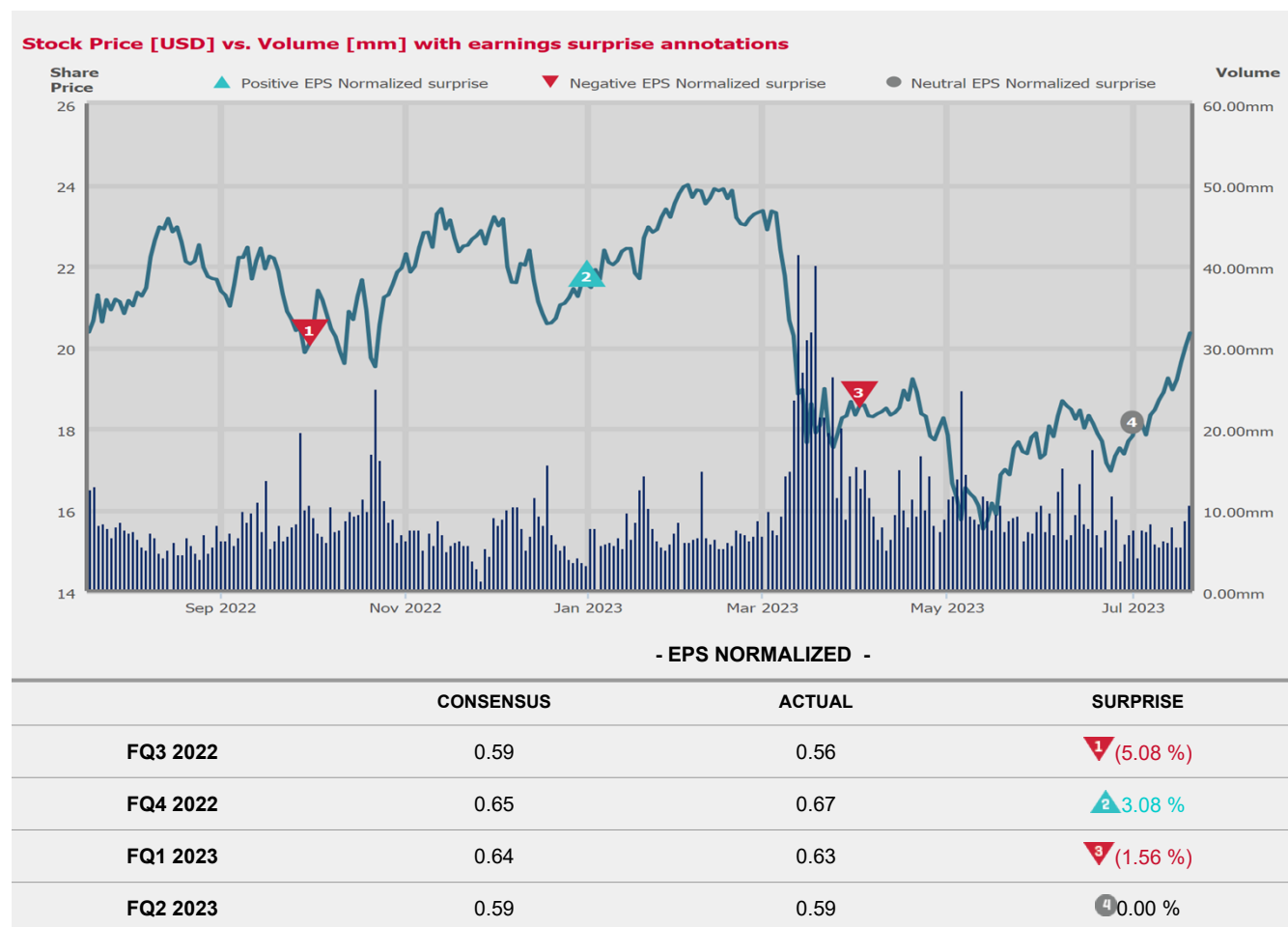
## FQ2 2023 Earnings Call Transcripts

**Friday, July 21, 2023 2:00 PM GMT**  
S&P Global Market Intelligence Estimates

|                | -FQ2 2023- |         |          | -FQ3 2023- | -FY 2023- | -FY 2024- |
|----------------|------------|---------|----------|------------|-----------|-----------|
|                | CONSENSUS  | ACTUAL  | SURPRISE | CONSENSUS  | CONSENSUS | CONSENSUS |
| EPS Normalized | 0.59       | 0.59    | 0.00     | 0.58       | 2.40      | NA        |
| Revenue (mm)   | 1945.55    | 1969.00 | 1.21     | 1887.39    | 7682.08   | NA        |

Currency: USD

Consensus as of Jul-21-2023 6:37 PM GMT



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# Call Participants

## EXECUTIVES

**Dana Nolan**  
*EVP & Head of Investor Relations*

**David Jackson Turner**  
*Senior EVP & CFO*

**John M. Turner**  
*President, CEO & Director*

**Unknown Executive**

## ANALYSTS

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*Jefferies LLC, Research Division*

**Matthew Derek O'Connor**  
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# Presentation

## Operator

Good morning, and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Christine, and I will be your operator for today's call.

[Operator Instructions]

I will now turn the call over to Dana Nolan to begin.

## Dana Nolan

*EVP & Head of Investor Relations*

Thank you, Christine. Welcome to Regions Second Quarter 2023 Earnings Call. John and David will provide high-level commentary regarding the quarter. Earnings documents, which include our forward-looking statement disclaimer and non-GAAP information are available in the Investor Relations section of our website. These disclosures cover our presentation materials, prepared comments and Q&A.

I will now turn the call over to John.

## John M. Turner

*President, CEO & Director*

Thank you, Dana, and good morning, everyone. We appreciate you joining our call today. Once again, Regions delivered another solid quarter, underscoring our commitment to generating consistent, sustainable long-term performance. We generated earnings of \$556 million resulting in earnings per share of \$0.59 and one of the best return on average tangible common equity ratios in our peer group at 24%. Our consistent strong earnings performance has given the board confidence to increase the quarterly common stock dividend by 20%, which was officially reported in a press release earlier this week.

Although some lingering economic uncertainty remains, we feel good about our ability to carry this momentum into the second half of the year. We continue to benefit from our strong and diverse balance sheet, robust liquidity position, and prudent credit risk management. Our proactive hedging strategies have positioned us for success in any interest rate environment. And our granular deposit base and relationship-based banking approach continue to serve us well.

Overall sentiment among our corporate customers remains relatively positive despite ongoing labor shortages, persistent inflationary pressure and slowly improving supply chain issues. In fact, most are continuing to forecast solid performance in 2023, although they are expecting modest declines from levels experienced in 2022. We remain committed to serving our customers while maintaining our focus on risk-adjusted returns. We're being judicious with capital, preserving it for our best clients and relationships.

Year-to-date, the corporate bank has grown loans 2%, in line with our expectations with the vast majority of this growth coming from existing customers. Our consumer customers also remain healthy. Unemployment in 7 of our 8 top states remains at or near historical lows. And housing prices in 13 of our 15 states are forecast to outperform the HPI index in 2023. Wages in much of our footprint have kept pace with or exceeded increases in inflation. And as a result, consumer deposit balances and credit card payment rates remain higher than pre-pandemic levels.

Our credit quality remains strong. Although normalization continues, charge-offs remain below historical through-the-cycle levels. We also continue to benefit from the strategic investments we're making in our business. For example, over the last few years, we focused on enhancing our treasury management suite of products and services. We've invested in talent and technology, including data and analytics, improving our ability to provide our clients with data-driven insights.

Today, our relationship managers lead every prospective client conversation with a cash flow mindset, enabling us to clearly understand our customer needs. We are very pleased with the success of our treasury management business which has produced 13% revenue growth year-over-year. Although our penetration rate for treasury management solutions ranks among the top versus peers, we continue to see further opportunity in our existing customer base, particularly in lowering commercial.

Additionally, during the second quarter, we introduced regions no-cost Overdraft Grace feature, giving consumers the opportunity to remedy overdrafts and avoid fees. To date, the data indicates that customers are seeing an approximate 30% reduction in the occurrence of assessed fees. We're excited about the financial benefits and flexibility, our customers are enjoying as a result of the

changes we've made over the past 2 years. We also continue to actively search for investment opportunities with respect to mortgage servicing rights.

And during the last 18 months, we've acquired the rights to service of approximately \$23 billion in mortgage loans through a combination of bulk purchases and flow deals. These are just a few examples of our commitment to investing in markets, technology, talent and capabilities that grow and diversify our revenue base and enhance offerings to our customers.

Now Dave will provide some highlights regarding the quarter.

**David Jackson Turner**  
*Senior EVP & CFO*

Thank you, John. Let's start with the balance sheet. Average loans increased 1% sequentially. Average business loans also increased 1% reflecting high-quality, broad-based growth across the telecommunications, multifamily and energy industries. Loan demand remained stable during the quarter, and we had the opportunity to continue growing faster. However, as John mentioned, we are committed to appropriate risk-adjusted returns and now is not the time to stretch for growth. We are focused on supporting existing customers where we have a relationship and proven history.

Approximately 84% of this quarter's business loan growth was driven by existing clients accessing and expanding their credit lines. Average consumer loans increased 1% as growth in mortgage and EnerBank was partially offset by declines in home equity and runoff exit portfolios. Looking forward, we expect 2023 ending loan growth of 3% to 4%.

From a deposit standpoint, our deposit base remains a strength and a differentiating factor across the peer set with balances continuing to largely perform as expected. Our deposits are highly operational in nature, granular in size and generally receive more coverage through FDIC insurance than most peers. Although banking turmoil linked the first quarter introduced some additional uncertainty to the company's outlook, deposits largely performed as expected, ending the first half of the year down \$4.8 billion.

As part of our practice of maintaining a diversity of funding sources, total deposits include approximately \$1 billion of deposits composed of brokered CDs and wholesale market transactions. Recall, this is in addition to the brokered CDs, we acquired as part of the EnerBank acquisition, which are maturing over time. Deposit declines came largely from higher balance and more rate-sensitive customers across all 3 businesses.

We also saw continued diversification of customer dollars across various Regions offerings, such as from interest-free checking to CDs or money market deposits and movement out of deposits to offerings through our Wealth Management platform and in the corporate banking segment, utilization of off-balance sheet money market mutual fund solutions.

In the case of corporate clients, overall liquidity under management has remained solid, increasing almost 3% since the end of the first quarter. Looking forward, a tightening Federal Reserve observed through increasing interest rates and reductions in the Federal Reserve's balance sheet, along with heightened competition will likely continue to constrain deposit growth for the industry through year-end. Accordingly, we expect deposits to be modestly lower over the balance of the year, and we expect the continued remixing into interest-bearing categories.

So let's shift to net interest income and margin. As expected, net interest income declined by 2.5% in the second quarter. This represents the beginning of a reversion from elevated net interest income and margin levels back towards our longer-term range, mostly due to deposit and funding cost normalization. Regions' balance sheet remains asset sensitive. As the Federal Reserve nears the end of its tightening cycle, the net interest income is supported by elevated floating rate loan and cash yields at higher market interest rates and fixed rate asset turnover from the maturity of lower-yielding loans and securities.

At this stage in the rate cycle, we expect deposit cost increases through a continuation of repricing and remixing trends. Importantly, recent trends remain within our expectation. The cycle-to-date deposit beta is 26%. And our guidance for 2023 is unchanged, a 35% cycle-to-date beta by year-end. Longer term, deposit performance will be heavily influenced by the amount of time monetary policy remains tight. Deposit betas could ultimately exceed the 35% in 2024 assuming higher rates for longer. Regardless, we remain confident that our deposit composition will provide a meaningful competitive advantage for Regions when compared to the broader industry.

Net interest income is projected to grow between 12% and 14% in 2023 when compared to 2022. The midpoint of the range is supported using June 30 market forward interest rates or approximately 1 additional 25 basis point hike this year. Third quarter net interest income is expected to decline approximately 5%, driven by continued deposit and funding cost normalization and the beginning of the active hedging period for a number of previously transacted forward-starting receive fixed swaps.

The balance sheet hedging program is an important source of earnings stability in today's uncertain environment. Hedges added to date create a well-protected net interest margin profile through 2025. While no meaningful hedging was transacted during the quarter, we continue to look for opportunities to add balance sheet protection beyond 2025 at attractive market rate levels.

Since quarter end, we have added \$1 billion of forward starting swaps and \$500 million of forward starting rate collars, near recent highs that will become effective in 2026, 2027 and 2028. The resulting balance sheet is constructed to support a net interest margin range of 3.6% to 4% over the coming years, even if interest rates move back towards 1%. If rates remain elevated, our net interest margin is projected to remain at or above the midpoint of the range.

Let's take a look at fee revenue and expense. Adjusted noninterest income increased 8% from the prior quarter as increases in capital markets and card and ATM fees were partially offset by declines in other categories. Total capital markets income increased \$26 million. Excluding the impact of CVA and DVA, capital markets increased 3% sequentially, driven primarily by growth in real estate capital markets, partially offset by declines in M&A fees, debt underwriting and loan syndication income.

We had a negative \$9 million CVA and DVA adjustment, reflecting credit spread tightening during the quarter. However, this was a \$24 million improvement versus the first quarter. Card and ATM fees increased 7%, driven by seasonally higher spend and transaction volume as well as a first quarter \$5 million rewards reserve adjustment that did not repeat.

Service charges declined slightly during the quarter. As John mentioned, we introduced our Overdraft Grace feature in mid-June. Based on our experience to date, we now expect full year service charges of approximately \$575 million. With respect to outlook, we continue to expect full year 2023 adjusted total revenue to be up 6% to 8% compared to 2022.

Let's move on to noninterest expense. Adjusted noninterest expense increased 8% compared to the prior quarter and includes the previously announced elevated operating losses related to check fraud. Excluding the approximately \$80 million associated with incremental check fraud incurred this quarter, adjusted noninterest expenses remained relatively stable versus the prior quarter. We have effective countermeasures in place and losses have returned to normalized levels. Salaries and benefits decreased 2%, primarily due to lower payroll taxes and 401(k) expense partially offset by an entire quarter of annual merit increases and higher headcount.

The FDIC insurance assessment increase was driven by changes in various inputs, including normalized credit conditions and increases in average assets. We remain committed to prudently managing expenses in order to continue funding investments in our business, including optimizing square footage. As an example, this quarter, we entered into an agreement to sell 2 of our largest operation centers, totaling over 450,000 square feet. We will continue to refine our expense base, focusing on our largest categories, which include salaries and benefits, occupancy and vendor spend. We expect full year 2023 adjusted noninterest expenses to be up approximately 6.5% and continue to expect to generate positive adjusted operating leverage.

From an asset quality standpoint, overall credit performance continues to normalize as expected. Net charge-offs were 33 basis points in the quarter. Nonperforming loans decreased while business service criticized loans and total delinquencies increased. Provision expense was \$118 million or \$37 million in excess of net charge-offs. The allowance for credit loss ratio increased 2 basis points to 1.65% and the allowance as a percentage of nonperforming loans increased to 332%. The allowance increased due primarily to normalizing credit, modest economic outlook changes and loan growth.

Allowance for credit losses on the office portfolio increased from 2.2% in to 2.7%. Importantly, the single office loan on nonperforming status is paying as agreed. Additionally, the vast majority of our office exposure is in Class A properties, located primarily within the Sunbelt. Overall, we continue to feel good about the composition of our office book and do not expect any meaningful loss in this portfolio. While we expect net charge-offs will continue to normalize over the back half of the year, we continue to expect our full year 2023 net charge-off ratio to be approximately 35 basis points. We also expect to return to our historical through-the-cycle annual charge-off range of 35 to 45 basis points in 2024.

From a capital standpoint, we ended the quarter with a common equity Tier 1 ratio at an estimated 10.1%. Although we were not required to participate in this year's supervisory capital stress test, we did receive our preliminary Stress Capital Buffer reflecting planned capital changes, including the dividend increase John referenced. Our preliminary Stress Capital Buffer will remain at 2.5% from the fourth quarter of 2023 through the third quarter of 2024. Additionally, we have access to sources of liquidity at June 30, totaling approximately \$53 billion including collateral we have in a ready status at the Federal Home Loan Bank, the Federal Reserve's Bank Term funding program and the discount window. These sources are sufficient to cover all retail uninsured deposits plus wholesale nonoperational deposits by approximately a 3:1 ratio. Given current macroeconomic conditions, and regulatory uncertainty, we anticipate continuing to manage capital levels at or modestly above 10% over the near term.

And finally, we have a slide summarizing our expectations which we have addressed throughout the prepared comments. With that, we'll move to the Q&A portion of the call.

# Question and Answer

## Operator

[Operator Instructions]

Our first question comes from the line of Scott Siefers with Piper Sandler.

### Robert Scott Siefers

*Piper Sandler & Co., Research Division*

Just wanted to ask a little on the deposit pricing thoughts. So you kept the interest-bearing deposit beta assumption, which was great, but softened the deposit growth expectation a bit. Maybe a thought or 2 on how you're thinking about the balance between flows and pricing. And then when we think about that beta assumption potentially going higher into next year as you had suggested vis-a-vis the third -- current 35% expectation. What are sort of the major puts and takes as you think about it? I mean, obviously, sort of time is a big one, but would just be curious to hear your thoughts.

### David Jackson Turner

*Senior EVP & CFO*

Sure. This is David. So with regards to deposit pricing, it's important that I understand that we think about our customers, we talk to our business leaders in terms of what we need to do to support our customer base and what's going on from a competitive landscape. And so through that, we form an opinion as to what our deposit beta ought to be. And I would tell you that going into last quarter, we've had 35% beta now for -- since the beginning of the year. We had a little bit cushion in that, we believe, pretty conservative. Based on what we've seen and the competitive pressures that we've seen, and obviously, events of March 8, it's probably not as conservative. We believe it's the right number, but we don't have as much conservatism in it as we had.

With regards to what we're thinking about beta going into 2024, we really need to understand what the Fed is thinking. And right now, if they have one more increase and kind of stay on hold for a while. You probably have a couple of quarters before betas stopped creeping up on you. So we had originally called for the end of the cycle at the end 2023 because this has been elongated a bit, the cycle is going to continue into 2024 to some degree. And that's all dependent on when they stop. And so if they have one more increase at the next meeting, it will be sooner, if they keep going another increase after that, it will be later. So those are probably the biggest individual drivers.

You have other things like competition, whether we have to be competitive. And so what our competition does, we have to react to, to some degree. So that's another driver. And then the overall Fed balance sheet. So the Fed is down about \$800 billion since the beginning of the year, Fed -- the balance sheet is going to continue to drift down a little bit, which will take liquidity out of the system and put some pressure on there. So there are several things. That's why it's hard to be precise on what the beta is going to be. But I think there should be some expectation that there's a little bit of an increase in 2024, the amount of which we can't tell you precisely, we'll continue to look and search for that and update you as we change our opinion on that.

### Robert Scott Siefers

*Piper Sandler & Co., Research Division*

And then I wanted to ask just a super quick one on sort of the background behind the favorable \$25 million adjustment you made to the expected full year service charges number. It sounds like it's simply a better understanding based on the early observations from the rollout of the new -- but would love to hear any incremental color you have there as well, please.

### David Jackson Turner

*Senior EVP & CFO*

Yes, it actually wasn't that. The driver is because our -- what's embedded in the service charge is also treasury management. And our treasury management group has done a great job this year growing relationships. We're up about 9% of our relationships. And if you look at revenue, our revenue on treasury management is up some 13%. And so we saw that happen in the first part -- the first quarter. We want to see if it continued, it did in the second quarter. And so our service charge from 24-hour grace is about what we -- where we forecasted it. So you add all that together and just on a run rate basis, you can see we were going to be higher than what we had originally guided, and that was the single driver.

## Operator

Our next question comes from the line of Gerard Cassidy with RBC.

**Gerard Sean Cassidy**  
*RBC Capital Markets, Research Division*

David, can you share with us -- I know we don't know what the final outcomes will be from the regulatory changes that are on the horizon, possibly we get them next week. But can you share with us how you guys are thinking about how it might impact you in terms of the long-term debt portion of the TLAC as well as the higher risk-weighted asset assumptions possibly for mortgages, which came out, I think, this week. And any other issues that are surrounding this whole regulatory change that's on the horizon.

**David Jackson Turner**  
*Senior EVP & CFO*

Sure. So let me just give you an overall comment, then I'll break down some of the elements. So overall, Gerard, what we're hearing, what we're seeing, we can -- we'll be able to adapt and overcome whatever it is that we have to. We think the Fed is going to give us all time to adapt to whatever those changes are going to be without any major disruption.

So specifically on debt, we're hearing potentially a 6% of RWA number for those over \$100 million. Maybe there's some tailoring, but let's just use the 6% for easy math. That's an incremental \$5 billion of debt for us that we'll have to raise over time. We'll be able to leverage that \$5 billion into our business and including putting some of it at the bank that will reduce our deposit insurance premium some. And when you wrap all that together, you're talking about 60 to 70 basis points of all-in cost for us on that \$5 billion. So you're talking about \$35 million bottom line hit if that were to happen, fully implemented. So it's just not -- it's not something that's pretty easy to overcome. We don't think it's necessary, but we don't get to make the rules. We just have to adapt and overcome.

With regards to the RWA, so we're hearing conflicting things. There's clearly some additional operational risk we're going to have to put into RWAs. We're supposed to get some benefit, though, on the credit side, whether that be from mortgages or investment grade. If all that happens like Basel intended, then it's a push and no big deal.

On the other hand, if we don't get the benefits we're supposed to on the credit risk weights, then that will cost us a little bit of capital. And again, we'll feather that in over time. Outside of Basel, but probably part of the NPR that will be coming out will be AOCI. AOCI is likely to be in the capital regime going forward, which, on a stress basis, actually is helpful because your AOCI is in a gain position. But in a rising rate environment, which is good for banking because that's where we make most of our money.

From a capital standpoint, you'll have to feather that AOCI in over time. Again, they're talking about starting maybe in 2025 or 2026 and then giving you 3 to 5 years to do that. And again, we can -- we'll be able to handle that. Some of that takes care of itself just because of the maturities of the investment portfolio. And so -- and then rates coming down the other way. So again, the bottom line is where I started, whatever it is, we'll adapt and overcome.

**Gerard Sean Cassidy**  
*RBC Capital Markets, Research Division*

Very good. And then I think you guys mentioned that you sold a couple of operation centers or you're in agreement to sell a couple of operation centers. I didn't hear, are you going to vacate them as well? Or is it just more of a sales leaseback situation? And then second, the price you received for them, how does that compare to what they may have been valued a couple of years ago at...

**David Jackson Turner**  
*Senior EVP & CFO*

Yes. So the first part is we will lease one of the buildings back some of the square footage for a relatively short period of time to help us transition. But for the most part, we're going to be vacating both of those buildings. I mean the world has changed since we built all of that. And so we just don't need the space. And of course, working remotely has been a piece of that, too. So we think it's a good deal, not only for our customer base, but for our community because what's going there, we think, will be very helpful to the community. We're going to be able to get out of -- sell that. It will be [ right at ] book value to a slight gain on the sale, not anything to write home about, but we'll make a little bit of money on that.

**Gerard Sean Cassidy**  
*RBC Capital Markets, Research Division*

And David, was the values lower than what you think if you would have sold those 2 or 3 years ago? Just to tie into the whole commercial real estate lower values that we're hearing about.



**John M. Turner**  
*President, CEO & Director*

Yes. Gerard, it's John. I'm not sure it's a relevant question. We're selling to the taxing authority that -- so we're selling to the city that we occupied and our tax valuation was unchanged over the 3-year period. And so it's based on tax valuation. So I'm not sure that we can give you a good answer to your question.

**Operator**

Our next question comes from the line of Ken Usdin with Jefferies.

**Kenneth Michael Usdin**  
*Jefferies LLC, Research Division*

David, just wondering your expectations for deposits to go down a little bit towards the end of the year, and you mentioned the additions of some of those brokered CDs. I'm just wondering what you think of the trajectory for average earning assets from here, if the [ right side ] is kind of coming down a little bit in loan growth, you've kind of given your clear view of that and just wondering how that fits in with the securities and cash in between in terms of what AAA does.

**David Jackson Turner**  
*Senior EVP & CFO*

Yes. I think you'll see a modest decline there, Ken. I think the deposit decline normalization. Remember, we had a lot of surge deposits. We've been calling for run off a bit. We were pretty close to our number through the second quarter. Rates are higher or longer. I think that's going to have some switching costs associated with it. There's going to be some off-balance sheet movement as well. We think our noninterest-bearing drifts down to that mid-30s, which is what we've been calling for. I think today, we're at about 37%.

So as a result of that decline, you should expect average earning assets to decline along with that. When we talk about modestly, we're talking 1% to 2%, frankly. And -- but we'll see. We're continuing to grow checking accounts. The core of our franchise are checking accounts and operating accounts, and we are all over trying to grow that and take advantage of the markets that we're in, which is very favorable as we see the migration of people and businesses into our markets. So we think this is some more normalization and then we think it kind of settles out after that modest decline.

**Kenneth Michael Usdin**  
*Jefferies LLC, Research Division*

Great. Okay. Got it. And just on the loan side, I was just wondering, resi mortgage and EnerBank have been the biggest parts of your loan growth for a while now. Just wondering, is that continue to be your expectation of where you'll get the majority of growth? And within that, I guess, if you can just give us an update on how EnerBank has been doing relative to your expectations.

**David Jackson Turner**  
*Senior EVP & CFO*

Sure. So our growth has really driven thus far in total from the commercial side. That is going to slow a bit. We can just -- as we talk to customers, we could see the demand for credit isn't quite what it was. Obviously, there are transactions that are harder to get done in real estate because we are based on the -- where rates are, we're requiring more equity in the deal and developers don't want to do that. So things don't happen. There's still a big demand for housing, our resi portfolio will continue to grow some. We have a good group of MLOs that are out there. The housing supply is still way below where it should be. Now rates are up. And so that's going to mute things.

From an EnerBank standpoint, we've had pretty good growth. They have met the expectations that we have laid out for them. We'll see some slowing a bit in the second half and into 2024. We had a pretty big solar program going at one time. The math on that got to a point where it was not as profitable as we had originally hoped for. And so we are not going to change -- chase loan growth until -- unless we can get paid appropriately for the risk that we take. As a result, that's going to slow a bit and EnerBank. That being said, we're very happy with what they're doing and you're going to see growth just not at the pace that we have had.

**Operator**

Our next question comes from the line of Dave Rochester with Compass Point.

**David Patrick Rochester***Compass Point Research & Trading, LLC, Research Division*

On your NII guide, I was just wondering about the timing of the rate hike you're factoring in there. It sounded like you're assuming July. I just wanted to confirm that. And then on your deposit comments, that you're factoring in that decline further on the DDA side and just overall, was just wondering what the rough average cost is of that incremental deposits that you're bringing in to replace some of that DDA? What's your assumption there? Is it 5%, 5.5%? Or is it closer to maybe some of your lower core accounts?

**David Jackson Turner***Senior EVP & CFO*

Yes, it's right at 5%. And you're correct, we did factor in the increase -- rate increase in July.

**David Patrick Rochester***Compass Point Research & Trading, LLC, Research Division*

Okay. Great. Maybe on capital, the plan to manage CET1 at or slightly above 10%. Given you're there now, I just wanted to get your thoughts on the chances of your restarting the buyback once you get more clarity on the capital requirements next week? Or do you think there's maybe a better possibility that you restart that in 4Q?

**David Jackson Turner***Senior EVP & CFO*

It's probably more likely a 4Q. We keep thinking we're going to get clarification. We thought June 30 has been pushed out. So we don't know exactly when we're going to get it. But whatever we do, we'll shift through the material and we'll come up with an appropriate plan. Until we know that plan, it just doesn't make any sense. I mean we had, I think, the highest return this quarter on tangible common equity. There's just no need for us to push on the -- to push on share buyback right now. Let's just be a little bit cautious and deal with the rules. And then after that, if buying our shares back is appropriate, then that's what we'll do.

**David Patrick Rochester***Compass Point Research & Trading, LLC, Research Division*

Okay. And maybe one, last one on credit. Just wanted to get your thoughts on your office reserve ratio at this point. I know you don't know what's in the other office books out there, some of these other banks, but we're just seeing some reserve ratios that are a little bit more elevated at some of the larger banks. And I know you mentioned you don't expect any losses in that book. I was just hoping you could just talk a little bit more about what's giving you comfort with that the 2 handle that you've got on there right now on the reserve ratio.

**John M. Turner***President, CEO & Director*

Sure, yes. This is John. I'll answer that. So our office portfolio is about \$1.7 billion, roughly 36% of that portfolio is single tenant. And of that single tenant exposure, 82% is investment grade. So we sort of look at that \$700 million and feel like we understand that. It's well secured, it's performing. So then we look at the \$1 billion portfolio that remains that's multi-tenant, 63% of that is in the Sunbelt. Beyond that, it is well diversified geographically. Largest concentration we have is in the Dallas-Fort Worth market, where about 20% of the portfolio, our exposure actually resides.

There are about 100 credits make up that \$1 billion. So we have very good visibility into the relationships and to the performance of those particular credits. When I think about how we're doing, we've been talking to customers well in advance of maturities, and we have a fair number of maturities in 2023 and 2024. Performance to date has been good. We've had 13 credits that have matured already this year and over half of those or half of those credits had an extension option, which they were able to exercise. Another 20-plus percent renewed based on our current credit underwriting standards and the balance either paid off.

We have one credit that we're still working on. That's the one nonaccrual that we have in the portfolio. And so all in all, our assessment of our portfolio, our office portfolio is pretty good. We have said we don't think we have any significant losses in the portfolio, and that's been confirmed by, again, conversations we're having with customers, our visibility into what's occurred to date and what we think will occur over the next 12 to 18 months.

**Operator**

Our next question comes from the line of Matt O'Connor with Deutsche Bank.

**Matthew Derek O'Connor**

*Deutsche Bank AG, Research Division*

Can you guys just remind us where you are on the system [indiscernible] on the loan and deposit platforms and what the benefits are once that's done?

**David Jackson Turner**

*Senior EVP & CFO*

Yes. So we are in the formative stage of putting in our new systems focusing on the deposit system. It will be the biggest and all of them are important to us, but that was really important to us. We are planning right now, we're laying the foundation. We are spending some money. We've been spending money for quite some time. But you're not going to see benefits for a number of years, Matt. We've got to go through. And we've learned from talking to others that have gone through these type journeys is, it is much better to take your time and be planful. It will reduce -- ultimately it will reduce overall cost.

So we're going through a number of customer journeys and really thinking through not just putting in a new system, but how can we really transform, how we do business and how can we make it easier for our customers to bank with us, how we can make it easier for our associates to take care of our customers. And so it's a lot of work. And so you're going to see cost upfront which is what we're experiencing today before you'll see the benefits, it will be a few years out.

**Matthew Derek O'Connor**

*Deutsche Bank AG, Research Division*

And remind us of the time line, I think it was back in 2019, you first started talking about it, I thought you said it might be 5 or 6 years, but update us on the time line, please?

**David Jackson Turner**

*Senior EVP & CFO*

That's right. It's going to be another 5 years from now before you see this. So we have a deposit system, we'll be putting in a new commercial loan system, and we'll be putting in a consumer loan system as well. But the biggest one and the most expensive one will be the deposit system. But that's at least 3 years out before that gets put in.

**Operator**

Our next question comes from the line of Erika Najarian with UBS.

**Erika Najarian**

*UBS Investment Bank, Research Division*

Quick question. Question is clarifying sort of the statements on NII, David. So based on your guidance, the fourth quarter 2023 net interest income quote exit rate will be somewhere between \$1.31 billion and \$1.32 billion. Sort of based on what you're telling us, should we expect perhaps a step down in the first quarter due to day count. And like you said, the continuation of beta creep, but then would there be stability from there or an opportunity for reprice if the Fed cuts? I'm trying to just triangulate your comments on NIM, which are very helpful to the NII quarterly cadence.

**David Jackson Turner**

*Senior EVP & CFO*

Yes. So I won't confirm your number exactly, but your thinking is spot on that as we get to the end of the year, we start stabilizing a bit. The question is, where does the Fed stop. If they go one more time and stop then you're -- then the only thing you really have leading into the first quarter will be slight beta risk and the day count that you talked about. So I think you have stability from there on.

However, if the Fed continues to push this out even more and has to go 2, 3 -- 2 more hikes, 3 more hikes and you just push everything out. We do have hedges that are becoming live this quarter. You can see that on our Page 6 in our deck. And so we put those on over a year ago with anticipation that there was risk that rates actually roll over and start going down, they didn't. And so we'll be in a bit of a negative carry on those, which is okay because the rest of our book is earning a whole lot more money than we thought at that time. So that's all been factored in to the guidance that we gave you. And we're -- right now, we're expecting that we get to the end of the year and things really start to settle out with the exception of minor tweaks in that first quarter.

**Erika Najarian**

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*UBS Investment Bank, Research Division*

Got it. And could you remind us sort of how much in total is the check fraud as you have in your expense base for 2023. And as we think about your natural [Technical Difficulty] run rate?

**David Jackson Turner**  
*Senior EVP & CFO*

Yes. So we have a schedule in our supplement on it. Let me flip and see if I can find it real quick for you because we were anticipating this question. We wanted to give everybody an understanding. It's on Page 15 of the supplement. And it's embedded in the operational loss number, and that change related to check fraud, was about \$80 million, as we mentioned in the call. But you can see our operational losses had averaged about \$13 million to \$18 million per quarter, and we are back to that kind of run rate now. And so we expect to be there about that number going forward.

**Erika Najarian**  
*UBS Investment Bank, Research Division*

Got it. And if I could just squeeze one more in, and this is for John. We're sitting here now July 21, 2023, and your firm is in a position of great strength. I'm wondering -- and I'm asking about organic opportunities. I don't think I'm wrapping an M&A question around this. But as you think about [ as you ] go on more stringent RWA diet -- than you -- given where your capital is today, how are you thinking about playing offense as we think through all the changes. How do you leverage that deposit base that will stay inexpensive and the capital that seems to be building nicely in the credit that seems relatively stable.

**John M. Turner**  
*President, CEO & Director*

Erika, we're continuing to add talent. So we're continuing to hire talent. We're in some very good markets. We have acquired a number of capabilities over the last number of years. And so it's really combining talent with opportunity in markets with additional capabilities, just to execute our plan. We're asking our bankers to be active in markets, talking to customers and noncustomers looking for ways to expand our business while there's still some economic uncertainty, and we want to be prudent and careful. We start with soundness first, followed by profitability and then growth. We think we are in a position, as you pointed out to win market share, where opportunities exist and we're focused on those prospects that we've been calling on for a long time and relationships that we've had for a long time to ensure that we use the capital and the resources we have to support those companies as they want to grow their businesses.

**David Jackson Turner**  
*Senior EVP & CFO*

Yes, Erika, this is David. Let me add to that. So we do realize there could be opportunities for us to grow loans faster than what we just gave you the guidance on. So we gave a guidance of 3% to 4%. We produced that slightly because of the demand that I had talked about earlier. We want to grow relationships. We aren't interested in taking advantage of somebody's RWA diet and growing loans only. We cannot outstrip our funding base because that marginal profitability just won't be there if you're having to wholesale fund that growth. So if we can get a relationship that brings an operating account and other deposits, we're all over that. But we're not interested in just growing loans because somebody else wants to shed that risk.

**Operator**

Our next question comes from the line of Betsy Graseck with Morgan Stanley.

**Betsy Lynn Graseck**  
*Morgan Stanley, Research Division*

Yes, just a ticky-tacky one at this stage. AOCI, pull-to-par, what should we be thinking about with regard to how that's going to pull quarterly over the next 4, 6 quarters?

**David Jackson Turner**  
*Senior EVP & CFO*

Yes. I think we have a schedule in the back is on our Slide #17 that shows by the end of 2024, about 25% of that will be rolled in. And then by the end of the next year, about 39%. That's using just maturities in the forwards at this time.

**Betsy Lynn Graseck**

*Morgan Stanley, Research Division*

Okay. And that's on just the AFS book, obviously, right?

**David Jackson Turner**  
*Senior EVP & CFO*

That's correct.

**Betsy Lynn Graseck**  
*Morgan Stanley, Research Division*

And then your strategy for the security portfolio in general. Are you going to be adding to it over time? Or what are you doing with the excess deposit growth that you get?

**David Jackson Turner**  
*Senior EVP & CFO*

Yes. So we've historically been 18% to 20% of our earning assets and securities. We suspect we'll be roughly in that range. What we have to think through is what the new regime will be with regards to AOCI. As you're probably aware, the AOCI changes with regards to securities becomes part of your capital, but the fair market value changes with regards to derivatives is not. And so what that does is it causes you to at least think about, if we need the duration protection that we use our securities book for along with liquidity. That perhaps we use more derivatives than securities. And we'll just have to see. But I don't see that changing our securities book appreciably, will it be down a notch or 2 perhaps. But I don't think you would -- you should expect us to grow that book much past that 20% range.

**Operator**

Our final question comes from the line of John Pancari with Evercore.

**John G. Pancari**  
*Evercore ISI Institutional Equities, Research Division*

Back to the deposit beta. I know you indicated the potential for an increase in 2024 if rates remain elevated. Any way to help us size it up, and does the 35 go to 40, is that most likely if we are in a higher longer environment? Or could it be up there where some of your competitors are flagging in the mid-40s and maybe even up there in the 50s where some of them are at. Just curious if you can help us frame it out.

**Unknown Executive**

John, this is Darren Smith. I'll take that one. So I think you're in the right neighborhood. Our expectations would be that if the Fed is indeed done over the next couple of meetings. And then what you're seeing is just that residual beta creep that plays out over a couple of quarters, and then you have very modest increases from there. It obviously depends on how long we're at that level. But I think somewhere in the upper 30s to around 40% is reasonable in terms of how much it may continue to move.

**John G. Pancari**  
*Evercore ISI Institutional Equities, Research Division*

Got it, Darren. That's helpful [indiscernible]. And then separately, just back to Matt O'Connor's question on the systems conversion. Can you remind us of your expectation around the cost of the conversion? I know you had originally indicated that you don't expect it to impact your IT budget. Is that still the case? Or has it -- has that changed as you have [indiscernible] on a vendor, et cetera?

**David Jackson Turner**  
*Senior EVP & CFO*

Yes. So John, we're still in the formative stage of planning for that. I'll tell you there's a lot of things going on other than this -- the system integration with regards to technology. The environment is changing to Software-as-a-Service versus buying a system and capitalizing it depreciating that over time and skipping several of the upgrades because you don't want to pay for that.

Today, it's all going in the cloud. It's paying by the drink and that's more expensive. And it's -- so technology cost, it used to be technology costs go down over time. It does not appear to be the case. We're going to do our best to control that while making appropriate investments in technology because I think we can leverage that better than we do today. We use a lot of human capital to

do things. I think over time, you're going to see most everybody leveraging technology better. And so I think that right now, we're at 9% to 11% of total revenue. I can see that drifting higher a bit over time. But right now, that's our call of 9% to 11%. And we'll update you as things change.

**John G. Pancari**

*Evercore ISI Institutional Equities, Research Division*

And then 9% or 11% is the total IT budget?

**David Jackson Turner**

*Senior EVP & CFO*

All technology, yes.

**John M. Turner**

*President, CEO & Director*

Okay. Well, I think that's all the calls. So I appreciate everybody's participation today. Thank you for your interest in Regions. Have a great weekend.

**Operator**

This concludes today's teleconference. You may disconnect your lines at this time.

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