17-Jul-2020

Regions Financial Corp. (RF)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Regions Financial Corporation's Quarterly Earnings Call. My name is Shelby, and I'll be your operator for today's call. I would like to remind everyone that all participant phone lines have been placed on listen-only. At the end of the call, there will be a question-and-answer session. [Operator Instructions]

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

Dana W. Nolan

Executive Vice President & Head-Investor Relations, Regions Financial Corp.

Thank you, Shelby. Welcome to Regions' second quarter 2020 earnings conference call. John Turner will provide some high-level commentary, and David Turner will take you through an overview of the quarter. Earnings-related documents, including forward-looking statements, are available under the Investor Relations section of our website. These disclosures cover our presentation materials, prepared comments, as well as the Q&A segment of today's call.

And with that, I will turn the call over to John.

John M. Turner, Jr.

President, Chief Executive Officer & Director, Regions Financial Corp.

Thank you, Dana, and thank you all for joining our call today. Over the last four months, we have experienced tremendous disruption and uncertainty covered by both COVID-19 and overt examples of social inequality. The impact on our customers, communities, and associates has been profound and the resulting operating environment has been challenging.

As our country works through the current health crisis and takes steps to address the systemic racial injustices that impact so many people in our society, we remain focused on things that we can control. We're committed to supporting our associates, our communities, and our customers through these difficult times by providing much needed capital, advice and guidance, and financial support. It's incumbent on us to use our resources and expertise in ways that create positive change. Providing value to all stakeholders creates the foundation to deliver sustainable long-term performance.

The disruptive and uncertain operating environment has presented both opportunities and challenges. In the second quarter, we delivered $646 million in adjusted pre-tax pre-provision income. This was Regions' highest PPI in over 10 years and a reflection of our decade-long effort to optimize our balance sheet and improve risk-adjusted returns while making strategic investments, all to deliver sustainable performance and reduce variability in our revenue streams.

However, while the core business performance was solid, it was more than offset by an elevated provision caused by further deterioration in the economic outlook and the resulting impact on the risk ratings and credit quality. Just a few weeks ago, while acknowledging that conditions were fragile, I said, we were cautiously optimistic about the prospect for economic recovery in our footprint.

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The Southeast had fared better than other parts of the economy, as evidenced by the fact that the unemployment rate in the majority of Southeastern states had been better than the national average, and the number of small businesses that closed within the region because of the crisis was also below the national average.

Most of the states where we operate had reopened. Consumer deferral requests had begun to taper off and consumer spend continued to increase toward more normal levels. So clearly, there were some positive signs that we felt pretty good about. However, by the end of the quarter, certain areas in our footprint began experiencing an acceleration in COVID-19 cases and some states paused or reversed their reopening plans. The potential for a second wave of COVID-19 infections, coupled with uncertainty surrounding the extension or renewal of various aid programs including the CARES Act, has impacted our view on the potential pace of the recovery. While we have experienced positive momentum over the latter part of the quarter, much uncertainty remains and our provisioning reflects that.

As a result of this environment, we recorded a second quarter credit loss provision of $882 million. The provision reflects adverse conditions and significant uncertainty within the economic outlook, combined with downgrades in certain portfolios, particularly energy, restaurant, retail and hotel, as well as the impact of $182 million of net charge-offs. This quarter's provision also includes $64 million related to the initial allowance for non-credit deteriorated loans acquired in the purchase of Ascentium Capital, which closed on April 1.

We are committed to assisting our customers through this difficult time. However, we have not modified our rigorous credit review process and have continued to make risk-rating adjustments as necessary. In addition, all business loans granted to deferral have been reviewed and risk ratings have been adjusted in accordance with our existing policies.

Based upon the work we've done and our assumptions around the economic outlook, we do not anticipate substantial reserve bills during the remainder of 2020. We know the economy will continue to experience stress as we combat the public health crisis. However, we spent a decade strengthening our capital position and credit risk management framework, which have positioned as well to weather the economic downturn.

In the most recent round of Supervisory Stress Test conducted by the Federal Reserve, Regions exceeded all minimum capital levels. While we were pleased with our capital resiliency [ph] under stress (00:05:46), we believe our industry-leading hedging program, which became effective in 2020 will provide additional support to pre-provision net of revenue.

With respect to our common stock dividend, the Federal Reserve has introduced an income test where the common dividend cannot exceed the average of the trailing four quarters' net income. Management will recommend the board later next week that we maintain the dividend for the third quarter of 2020.

We are committed to effectively managing our capital strength and organic growth, generate sustainable long-term value for our shareholders, and continue lending activities to support customers and communities during the economic downturn. That being said, we must continue to focus on what we can control and remain committed to prudently managing expenses in the face of a challenging revenue environment.

Thank you for your time and attention this morning. With that, I'll now turn it over to David.

David Jackson Turner, Jr.

Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

Thank you, John. Let's start with our quarterly highlights.

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Second quarter results reflected a net loss available to common shareholders of $237 million, or $0.25 per share. Items impacting our results for this quarter included a significant credit loss provision, pandemic-related expenses, branch consolidation charges, expenses associated with the purchase of our equipment finance business Ascentium Capital and a loss on early extinguishment of debt. Partially offsetting the negative adjustments was a favorable CVA associated with customer derivatives as credit spreads improved significantly during the quarter, as well as net interest income derived from newly-originated Paycheck Protection Program loans. In total, we adjusted an additional selected item as highlighted on the slide, reduced our pre-tax results by approximately $692 million.

Let's take a look at our results starting with the balance sheet. Adjusted average loans increased 11%. Loan growth was driven primarily by elevated commercial draw activity. The addition of $2 billion in loans related to our equipment finance acquisition and $3 billion average impact from newly originated Paycheck Protection Program loans during the quarter.

Looking ahead, our focus remains on client selectivity and full relationships with appropriate risk adjusted returns. Commercial loan utilization levels normalized during the quarter as liquidity concerns have eased and corporate borrowers have access to the capital markets. In addition, corporate borrowers were generally feeling better about the economic outlook as the economy started to reopen. Although the recent rise in COVID-19 cases may temper that perspective.

With respect to PPP loans, it remains difficult to predict the timing of loan forgiveness. Currently, we anticipate forgiveness requests to begin in the third quarter and continue into the fourth. We will have a better idea around timing once the forgiveness process begins. Adjusted average consumer loans increased to 1%, reflecting declines across all categories except mortgage, which was up 3% reflective of historically low market interest rates.

Now, turning to deposits; deposit balances increased to record levels this quarter. Average deposits increased 16% while ending deposits increased 17% as many of our commercial customers have brought their excess deposits back to Regions while also keeping their excess cash from line draws, PPP loans and other government stimulus in their deposit accounts.

On an ending basis, corporate segment deposits increased 30% while wealth and consumer segment deposits increased 6% and 12% respectively. These increases were partially offset by a decrease in wholesale broker deposits within the other segment. Although commercial line utilization rates have normalized, corporate customers are using cash held outside of the bank to pay down line draws, which continues to support elevated deposit levels. We anticipate funds received through government stimulus and PPP will be spent by the end of the year and the remaining deposits will stay with us until interest rates begin to move higher.

Similarly, consumer deposits have continued to increased, primarily due to government stimulus programs coupled with lower overall spend. The delay in the tax filing deadline until July is also a contributor. We anticipate consumer balances due to decline in the second half of the year as consumers make tax payments, increase spending commensurate with improvement in the economy, and the current round of federal unemployment benefits expire at the end of July.

Let's shift to net interest income and margin which remain a strong story for Regions. Net interest income increased 5% linked quarter and, as expected, net interest margin decreased 25 basis points to 3.19%. Net interest income remains a source of stability for Regions despite an extremely volatile market interest rate

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backdrop. Linked-quarter, our equipment finance acquisition, elevated loan and deposit balances and our significant hedging program supported net interest income. The decline in net interest margin was mostly attributable to elevated liquidity. Specifically, elevated cash levels at the Federal Reserve and higher low spread loan balances associated with PPP account for approximately 19 basis points of margin compression. Efforts to reduce these elevated cash levels are ongoing.

During the quarter, $7.4 million of early extinguishment of FHLB advances and a $650 million bank debt tender directly reduced outstanding cash balances. The implications of liquidity on net interest margin are expected to abate over the remainder of the year. However, the impact remains uncertain, given the amount of liquidity in the system.

Now that most of our forward starting hedges have begun, and given our ability to move deposit cost lower, our balance sheet was largely insulated from the decline in short-term rates this quarter. Loan hedges added approximately $60 million to net interest income and 19 basis points to the margin. The benefits from hedging will continue to increase as the majority of the remaining forward starting hedges begin in the third quarter. Current estimates for the third and fourth quarters have hedging benefits approximating $95 million per quarter. Recall, our hedges have roughly five-year tenors and a quarter-end pre-tax market valuation of $1.9 billion, an important relative differentiator.

Total deposit costs were 14 basis points for the quarter, representing a linked-quarter decline of 21 basis points. Regions continues to deliver industry-leading performance in this space, exhibiting the strength of our deposit franchise. Over the coming quarters, we expect deposit cost to further decline to historical lows. Lower long-term interest rates negatively impacted net interest income and net interest margin during the quarter. Premium amortization increased $7 million to $33 million, attributable, in part, to an unusually low first quarter. Furthermore, the repricing of fixed rate loans and securities at lower market rates reduced net interest income and net interest margin by $8 million and 3 basis points respectively.

Looking ahead to the third quarter, let me start by saying the uncertainty surrounding the timing of forgiveness for PPP loans may create volatility in net interest income across quarters given the impacts from fee acceleration. We currently anticipate NII to decline between 1.5% and 2.5% linked-quarter mostly from the normalization of line activity that was elevated in the second quarter. Excluding PPP and excess cash liquidity, our core net interest margin is expected to stabilize in the mid to high 3.30s.

Now let's take a look at fee revenue and expense. Despite the challenging operating environment, adjusted non-interest income increased 18% quarter-over-quarter. Capital markets experienced a record quarter producing $95 million of income. Excluding favorable CVA, capital markets income totaled $61 million. Growth in capital markets was driven by record debt and equity underwriting as well as record fees generated from the placement of permanent financing for real estate customers.

In light of the current environment, it is reasonable to expect capital markets to generate quarterly revenue excluding CVA in the $40 million to $50 million range. Mortgage income increased 21%, driven primarily by record production volumes associated with the favorable rate environment. Lower interest rates have contributed to a significant increase in year-over-year production. In fact, our full-year 2020 production is expected to exceed full-year 2019 levels by 50%.

Mortgage remains a core business for Regions, and our strategic decision to add a significant number of mortgage bankers last year is paying off. Closed mortgage loans in the month of May represent the highest single

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month in our company's history, and we continue to experience elevated application volumes throughout the quarter.

In addition, mortgage servicing continues to be a strategic initiative. During the quarter, we initiated the new floor arrangement allowing us to grow the servicing portfolio after experiencing several quarters of net decline. We expect mortgage to remain a strength in the consumer bank for the remainder of the year.

Wealth management revenue declined 6%, driven primarily by lower investment services fee income, which has been negatively impacted by reduced branch activity. Service charges revenue and card and ATM fees decreased 26% and 4%, respectively, driven by lower customer spend activity. Consumer debit card spend has improved across the second quarter. In fact, the month of June transactions were up slightly year-over-year while spend was up over 15% year-over-year.

Consumer credit card spend has improved as well although June transaction levels were approximately 6% below the prior year while spend was down 4%. The current environment has led to reduced overdrafts and credit card balances are lower quarter-over-quarter. Looking forward, if current spend levels persist, we estimate consumer service charges and card and ATM fees will be reduced by approximately $10 million to $15 million per month from pre-March levels.

So despite elevated unemployment, consumers appear to be holding up well. They entered the pandemic in a position of strength; and while spend levels are improving, customers continue to delever while carefully managing their finances. Ramping up non-interest income, market value is associated with certain employee benefit assets improved during the quarter resulting in a significant quarter-over-quarter benefit.

While this increased non-interest income, it was fully offset by corresponding increase in salaries and employee benefits expense. Let's move on to non-interest expense. Adjusted non-interest expenses increased 9% compared to the prior quarter. Salaries and benefits increased 13% driven primarily by the liability impact associated with positive market value adjustments, unemployed benefit accounts.

Elevated production-based incentives, temporary COVID pay increases, the addition of approximately 460 associates from our equipment finance acquisition, as well as our annual merit increases also contributed to the increase. Professional fees increased 56% driven primarily by legal fees associated with the completion of our acquisition.

FDIC assessment increased 36% attributable primarily to the effects of unfavorable economic conditions at higher assessment base and a reduction in unsecured bank debt. In addition, expenses associated with Visa class B shares sold in a prior year, increased to $9 million. The company's second quarter adjusted efficiency ratio was 57.7% and the effective tax rate was 18.3%.

We continue to benefit from continuous improvement processes as we have just completed over 50% of the current list of identified initiatives. For example, excluding our equipment finance acquisition, we have reduced total corporate space by almost 700,000 square feet or 5% since the second quarter of last year.

Through the pandemic, we have learned how to interact and communicate with customers and each other in new ways. We have seen a dramatic increase in digital adoption and continue to have success through increased calling efforts using video conferencing. Our video conferencing accounts have increased by 128% since mid-March, and year-to-date, we have already surpassed the number of video conferencing sessions conducted in all of 2019. This is clear evidence our associates and customers are embracing alternatives to in-person meetings.

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In addition, year-over-year mobile deposits are up 36%, deposit accounts opened digitally are up 29%, and digital log-ins are up 24%. Further, almost half of our new digital users in 2020 have come from customers 40 years and over. In fact, digital played a significant role in our ability to assist our customers in obtaining PPP loans during the pandemic. Approximately 80% of applications were submitted online and 97% were closed using e-signature.

We've been actively reducing the size of our retail network for several years now. In fact, we consolidated 36 branches this quarter. Because of increased digital adoption and changing customer preferences, we expect branch consolidations to continue. Customers have an increasing desire for an omni-channel delivery model for their banking needs. So while we consolidate branches, we will continue to add new modern locations that are best suited to provide the advice and guidance our customers expect.

Similarly, we are evaluating our digital and technology spend priorities to best leverage the digital momentum we are experiencing. This shift will allow us to focus on enhancing digital banking capabilities, further advancing our digital sales capabilities, and leveraging e-signature to make banking easier for our customers.

We also believe there are additional opportunities where corporate space is concerned, whether through increased use of hoteling, work-from-home or modified scheduling, we're confident overall office square footage will continue to decline. Our expense number this quarter has a bit of noise in it, and I want to spend a few minutes walking through.

If you start with our adjusted total expenses of $898 million and back out unusual items we don't adjust for such as the expense associated with the employee benefit accounts and total COVID-related expenses, it gets back to a core quarterly run rate inclusive of our equipment finance acquisition in the $860 million to $870 million range. To be clear, we remain committed to making the investments needed to grow our business. However, our overall expense base must always be reflective of the revenue environment. So to the extent, the revenue environment is challenged, we will look for additional efficiency opportunities.

Let's move on to asset quality. The credit loss provision for the quarter totaled $882 million. The provision reflects adverse conditions and significant uncertainty within the economic outlook combined with downgrades in certain portfolios, as well as the impact of $182 million in net charge-offs. Portfolio level downgrades were made primarily within energy, restaurant, hotel, and retail, while economic outlook uncertainty is centered primarily on the impact of unemployment and the benefits of government stimulus already enacted and the potential for additional stimulus.

This quarter's provision also includes $64 million establishing the initial allowance for the noncredit deteriorated small business loans acquired as part of our equipment finance acquisition which closed on April 1. The resulting allowance for credit losses is 2.68% of total loans and 395% of total non-accrual loans, importantly, excluding the fully guaranteed PPP loans, our allowance for credit losses increases to 2.82% of total loans.

Annualized net charge-offs were 80 basis points this quarter. The increase reflects charges taken within the energy and restaurant portfolios. Additionally, for the first time, our results now include charge-offs related to our recent equipment finance acquisition. These charge-offs contributed to $24 million decline in total non-performing loans. Total delinquencies and troubled debt restructuring loans increased 6% and 5%, respectively.

Business services criticized loans increased 67%. Despite our willingness to work with our customers during this difficult time, we are not relaxing our credit policies and continue to revise risk ratings as necessary. This approach as well as specific portfolio level downgrades led to significant increase in criticized loans. We have

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executed a bottom-up approach to review all of our stressed business portfolios until this gives us good insight into potential loss and underlying stress over the second half of the year.

With respect to consumers, they entered the pandemic in good shape in relation to jobs, income, loan to values, et cetera. They have clearly benefited from the government stimulus, and recent momentum in the jobs numbers has been positive. However, resurgence of COVID-19 cases has slowed some re-openings and the expectation of certain federal benefits ending in July create some downside risk.

Based on the work we have completed and what we know today, we do not anticipate substantial reserve builds during the remainder of 2020. Additionally, we anticipate net charge-off levels for the remainder of the year to be consistent with the second quarter.

In addition, we've continued to refine our view of at-risk portfolios resulting from the pandemic. Through our engagement with customers and actual market observations gained through the quarter, we have a more informed view of which sectors can withstand operations in this new normal. As a result, the portion of our portfolio we consider to be at the highest risk of potential loss due to the pandemic declined from $12.4 billion at the end of last quarter to $8.4 billion at June 30. This amount includes loans acquired during the quarter from our equipment finance acquisition.

With respect to loan deferrals, we will have better insight in the next few weeks as the initial deferral periods expire. But we continue to see positive underlying trends. As of July 1, approximately 34% of clients have made mortgage payments while in forbearance in the last 61 days. For home equity, payments while in deferral have been 36%. Credit card is at 56%, and autos at 41%. And approximately 25% of our corporate banking clients in deferral have made a payment in the last 61 days. While we have modeled second business loan deferral request at approximately 40%, early trends indicate requests are tracking at less than 10% for both commitments and relationships.

Let's take a look at capital and liquidity. Our Common Equity Tier 1 ratio is estimated at 8.9%. In late June, we received notice that the company exceeded all minimum capital levels out of the supervisory stress test. Our preliminary stress capital buffer for the fourth quarter of 2020 through the third quarter of 2021 is currently estimated at 3%. This represents the amount of capital degradation under the supervisory severely adverse scenario and is inclusive of four quarters of planned common stock dividends.

These results allow Regions to manage capital in support of lending activities and focus on appropriate shareholder returns. Our current capital plan reflects a previously announced suspension of share repurchases through the end of 2020.

With respect to the common stock dividend, management will recommend to the board that the third quarter dividend remain at its current level. Looking ahead, we expect to maintain the dividend. However, future payout capacity will be dependent on earnings over the second half of the year and any constraints imposed by the Federal Reserve.

Also, it is important to note that we have approximately $1 billion of pre-tax security gains in OCI that are not included in our regulatory capital numbers, unlike advanced approach banks. We exclude OCI from our capital calculations but nonetheless it is available to absorb potential losses. As previously noted, we have an additional $1.9 billion of pre-tax gains on our cash flow hedges in OCI which is also excluded from regulatory capital. Terminating these hedges would not provide immediate recognition in income or capital as a gain would be deferred and amortized into income, therefore, supporting capital over the remaining life of the derivatives.

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These transactions are hedges designed to protect net income in a low rate environment. We believe there's incremental value in leaving the hedges live based on the current forward five-year LIBOR curve. However, we continue to evaluate and discuss positioning points. This demonstrates significant additional loss absorbing capacity which is not reflected in our regulatory capital levels.

With respect to liquidity, significant deposit growth during the quarter has contributed to historically elevated liquidity sources for the company. Deposits ended the quarter at record levels and contributed to a 10 percentage point decline in our loan-to-deposit ratio to 78%.

So, in summary, our robust capital and liquidity planning processes, which are stressed internally as well as externally by our regulators, are designed to ensure resilience and sustainability. This gives us confidence that we can continue to meet the needs of our customers and communities during this exceptional period of economic uncertainty.

Despite the uncertain environment, we remain focused on helping our customers, associates, and communities navigate through this difficult time. We have a solid strategic plan and are committed to its continued execution. Rest assured, during this extraordinary time, Regions stands ready to help and support all stakeholders.

With that, we are happy to take your questions. Considering the current environment, we do ask that each of you ask only one question to allow for more questions and participants. We will now open the line for your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question is from Betsy Graseck of Morgan Stanley.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning, Betsy.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC
Q

Hi. Good morning. Thanks very much.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

Good morning.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC
Q

Hi. Okay. A couple of questions. One, just on the outlook here for net charge-offs, you highlighted flat in 2H or so. And I guess I'm just trying to understand how you're thinking about the trajectory from there. Is it that at this current run rate, you feel like you're anticipating the near-term impact on the portfolio or is it that you don't expect an uptick in net charge-offs until things like stimulus roll off?

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Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.

A

It's Barb and I'll go ahead and respond to that Betsy. It's a couple of things. One is, we've done a deep dive on all of our portfolios. Virtually 95% of our business services portfolio, we've had conversations with the first line and credit together. We've talked to customer-by-customer et cetera. We've had ongoing discussions that some of them are happening weekly, some of them monthly, some of them biweekly et cetera. So we really feel good about the information we have on which to look and say, which customers may create an issue.

But we also made a change in our thinking over the – since the last Great Recession which is we don't want let problems age. So as we see a problem out there and we think it might head towards a charge-off, we are actually moving it towards charge-off, hoping we'll get a recovery in due course. That recovery is going to be much further out. So as we think about getting to – and that's part of what's in the second half thinking. As we get to the beginning of next year, what we anticipate is that on our business services side, the commercial part of the book that those numbers will indeed come down. And consumer is a bit of the wild card because you're right, once the deferments roll off and the stimulus rolls off, how will they behave? But so far, I'm pretty encouraged by what I see relative to people asking for things like second deferrals et cetera early on, but still encouraged somewhat on that front.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Okay. That's helpful color. I noticed, yes, the NCOs were up a little bit Q-on-Q more than what we've seen out of other institutions. So that reflects your more proactive stance I guess with moving people into the NPLs. Maybe you...

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah, and Betsy, just to correlate that, you see a little decline in non-performing loans quarter-over-quarter which I think is again a reflection of the fact that we're moving those charge-offs through the system.

Betsy L. Graseck
Analyst, Morgan Stanley & Co. LLC

Q

Yeah, exactly. Okay. Follow-up question just on the outlook for NII guide, down 1.5% to 2.5% in 3Q Q-on-Q, could you just give us some color around the inputs to that with regard to what you're thinking about for average earning asset growth versus the NIM? And then I know with the hedges, your core NIM is mid to high 3.30s. You've got some benefit from PPP at some point through the next couple of quarters as well. So maybe you can give us some sense of the trajectory for the main pieces into 3Q and then as we look for PPP how we should anticipate that flow through from here. Thanks.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

A

Yeah. There's a lot in there. Let me see if I can boil it down. So what we don't know is what the regime is going to be on forgiveness of PPP. So we don't have anything meaningful really coming through other than the carry that we are getting, which is pretty low carry. Probably the biggest driver is reduction in the loan book that we see. There were a lot of draws that happened in the late first quarter and in the second quarter. We saw about 80% of those be repaid by the end of the second quarter, but there's still some more that are going to be coming through. And so I think it's reflective of that continued decline in loans.

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The other is – so our deposits were up some 16%. A big part of that we believe is also driven by the fact that the tax payment date was moved to July 15, and so we should expect a run-off of deposits in the quarter and therefore using some assets from that standpoint.

So when you kind of add all that up, we're going to have premium amortization in terms of prepayment. So we had talked about that being up in the $33 million range this quarter. That's probably going to be close to the upper 30s this next quarter as we see prepayments increase. And then, we've talked about the reinvestment of cash flows from fixed rate loans and securities that have to go on the books at prevailing rates. That component of it cost us $8 billion this past quarter and that's harder to hedge out. So we're fully protected on the short-term moves, but we still have some exposure to the reinvestment piece. So you add all that up and that's where that decline in NII is coming from.

Betsy L. Graseck Q
Analyst, Morgan Stanley & Co. LLC

[ph] Super (00:38:18).

David Jackson Turner, Jr. A
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

Betsy, I should also point out that the benefit from our hedges in the first quarter were about $10 million. What we saw this quarter was about $60 million. And the benefit we'll see in the third quarter assuming rates are in the third quarter and beyond, all the way for five years is about $95 million so the hedges, we're very thankful that we have those and that's a big part of us keeping the stability of our NII and resulting core margin.

Betsy L. Graseck Q
Analyst, Morgan Stanley & Co. LLC

And so then, I know you don't have anything in your numbers for – or your guidance obviously for PPP, but as those loans are forgiven, you get a temporary uptick in your NII. And so, you're just going to treat that as a kind of a one-off, is that how we should be thinking about it?

David Jackson Turner, Jr. A
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

Well again, it depends on what the regime is. If we end up having an unusual bump in any given quarter, we'll point that out so that investors understand that. If it comes in over time and it's just kind of part of our business, maybe we wouldn't. But right now, it's just so – we don't know what the regime is going to be. And when we get further guidance on that, we'll tell everybody and reforecast for you.

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

David, this is Ronnie Smith, Betsy. Just to reiterate, there has been an extension from the initial eight-week period that businesses were able to count the funds that qualified for uses under PPP. So that 24 weeks has pushed that out a bit depending on which process the customer select.

Betsy L. Graseck Q
Analyst, Morgan Stanley & Co. LLC

Okay. All right. Thank you.

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John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Thank you, Betsy.

Operator: Your next question is from Ken Usdin of Jefferies.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Hi, Ken.

Ken Usdin
Analyst, Jefferies LLC
Q

Thanks. Hey. Good morning, everyone. Obviously with the big reserve this quarter, the CET1 ratio slipped a little bit below the 9% zone where you talked about being comfortable. And I just wanted to ask you to kind of flesh that out vis-à-vis your other comments about continuing to recommend the dividend. The back and forth between comfort on where your ratios sit, where do you think that CET1 can get back to and then put that in context of the income constraint and how you think about that, too. Thanks.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

Sure. So, I assume everybody is looking at the slide 18 where we have our waterfall and you could see the positive contribution generated from our core engine, our PP&R and then the impact of the dividend. So between those two is 50 basis points to the plus. We did have provision expense that drove that down as well as our acquisition of Ascentium in the first quarter.

So, I think we'd all acknowledge we're in some form of stress in the country and we've always said our mathematical calculation would lead us to desiring a Common Equity Tier 1 of 9%, we were holding a little excess capital to take advantage of opportunities, which one occurred, Ascentium. And so, you should expect – as you look at that waterfall chart, and again, we don't expect to have a provision at the level we just had. So we could accrete that capital back pretty quickly, while we also have pretty robust reserves, if you look at our coverage distressed losses now.

So, we couldn't pick the timing of when that particular transaction hit. We went to 8.9%. We're comfortable where we are. The dividend is not a capital adequacy issue. You can glean that from the DFAST analysis that came through.

Now, we are going through some form of a stress test in the fourth quarter, and we're not sure exactly what that regime is going to look like. What we do know is that we have for the third quarter, the dividend limitation on the past four quarters. Based on our math, as we mentioned in the prepared remarks, we'll be recommending to our board to sustain the dividend in the third quarter.

As we think about the fourth quarter and the first quarter of next year, we don't know if that regime will continue. We have to suspect that it might. And therefore, we gave you guidance that we believe our dividend is sustainable going out into the fourth quarter and into the first quarter based on our expectations of forecasted earnings.

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That being said, the two caveats are, let's see what the economy looks like when we prepare the financial statements for September 30, and we'll make whatever adjustments are necessary; and then whatever the Federal Reserve and supervisors may do in this fourth quarter analysis, we don't know. So, those are the two caveats. So, based on what we could see, we feel good about sustaining the dividend.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you, Ken.

Operator: Our next question is from Stephen Scouten of Piper Sandler.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Morning, Stephen.

Stephen Kendall Scouten
Analyst, Piper Sandler & Co.

Q

Hey. Good morning. Yeah, I was wondering if you guys could give a little more color around the loan deferrals. I know you said your expectations for second deferrals are maybe 40%, you're tracking under 10%. And I'm also kind of wondering how much of those maybe deferred loans that are still performing were downgraded from a rating perspective because it feels like you guys are ahead of your peers in terms of changing risk ratings, but I want to see if you can frame that up for us a little bit.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Barb, do you want to speak to that?

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.

A

Sure. Yes. So as we talked about deferrals in general, begin with – let me – I'll start with consumer work my way to business services really quick, Stephen. And so for consumer, what we saw is that deferral rate all-in, in fact for the company is about 6%. What I was looking at, in fact earlier this morning, is that those numbers are, in fact, coming down. And so far, in consumer, we've had no requests for a second deferral yet. Mind you, it's early. And some of the first deferrals are just rolling off, but it's still a good encouraging early sign.

For the business services portfolio, all-in, it's about 6% as well. And again, talking to our customers of -again, the benefit of these one-by-one conversations, we've heard very limited need for a second deferral, so again very encouraging news from that front.

Relative to those that are deferred and the percent that are criticized within those, we've given a chart on page 12, but doesn't give the criticized portion of the deferrals. But you can intuit from that. The criticized – a large portion of those criticized percentages were – do include a deferral.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Ronnie Smith, do you want to talk about the wholesale book?

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

A

Yeah, John. Just from – just numbers if I step back into it, Stephen. We have 2,000 clients in the wholesale book that have requested deferral and out of that particular universe, we are seeing and I think David said this in his opening comments, but we're seeing a very low request for a second deferral period. And we are using that though as a leading indicator to go in and provide a scrub on a name-by-name basis to appropriately assign risk ratings to those clients who had requested a deferral.

We're finding as you can tell, in the early returns and I want to stress it's early, less than 10% of those requesting a second deferral period. And so, that shows the strength of cash flows liquidity that they have built up. And so we feel good about where we are at this point. But there's a lot more deferrals that need to mature as we continue to work with each of these clients.

Stephen Kendall Scouten
Analyst, Piper Sandler & Co.

Q

Okay. Very, very helpful. If I could ask David one clarifier on the expense guidance – information you gave. You said $860 million to $870 million is kind of a better longer term run rate maybe. When do you think you can get to that level and what level of kind of PPP related expenses are within that number if you have any guidance there?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. So we think we can get there now, it's just – this past quarter I acknowledged, there's a lot of noise in our numbers and that's why we actually gave you a little better guidance to what to expect going forward. We had some expenses that came through PPP, that weren't particularly material in any of those that were related to loan originations are deferred as part of the fees that we get and would be amortized over the life of the loan. So I wouldn't expect anything material from that standpoint to hit us in the third quarter and going forward.

Stephen Kendall Scouten
Analyst, Piper Sandler & Co.

Q

Great. Thanks for the color. Appreciate the time.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you

Operator: Your next question is from Matt O'Connor of Deutsche Bank.

Matt O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

Hi.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Matt. Hi.

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Matt O'Connor
Analyst, Deutsche Bank Securities, Inc.

Q

I know you guys touched on this a little bit, but coming back to credit. I'd say it's an interesting day because your stock is getting hit because folks think you have worse credit because you reserve for more. Another company came out today and it was taken from [ph] heed (00:47:37) for maybe under-reserving. So, from an outside point of view, it's a little hard to tell like who's being aggressive, who's maybe behind.

And I guess from your point of view, like why do you think you are able to kind of be more aggressive than maybe some others? Is it the loan mix? Is it just the data that you have, as you've mentioned, has changed quite a bit in your markets the last six weeks? Is it the pain that you live through in the last downturn? Just anything else you could add on that. Thank you.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. It is only – I think last quarter we were criticized for potentially under-reserving and this quarter, there are some questions about credit. And I think I can't speak to what other banks are doing. What I do know is what we're doing. Over the last 10 years, we worked really hard to improve our credit risk management processes. And as Ronnie and Barb described, on the wholesale side of our business, we've been through the large majority if not all of our portfolios, high-risk portfolios, large exposures and we have risk credit – those credits we think appropriately. And as a result, our allowance for credit losses reflects those risk ratings.

We've considered companies – industries, their ability to repay and we're actively monitoring our portfolios. And so, have presented what we believe to be an appropriate allowance given the risk that's currently in our portfolio based upon the economic assumptions we're applying and expected life of loan losses. And it's our anticipation that the portfolio will, as David has described performed consistent with in the future, at least next two quarters, will charge-offs, will approximate where the current levels. And we don't anticipate any significant additional provisioning if there are no changes in the economic environment and if our credit quality doesn't further deteriorate because of changes in the economic environment.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Yeah. Matt, we're trying to help everybody on our page 19 showing the allowance waterfall and you can see the economic outlook component of $242 million that was added to the reserve. And that's a reflection of – the primary driver for this is unemployment. So when we were at the first quarter, our expectation of unemployment was closer to 9%. Today it's 13%. That's a big delta. And the question is how quick is the recovery going to be, what's the impact of the stimulus. So there's a lot of work that goes into ultimately determining what the allowance needs to be.

We are risk rating, and Barb may want to chime in on this, risk rating and relative to what we see in the book from the ground-up process that was earlier described. And that's the $382 million that you see in the middle of that page. Now, remember on top of that is the charge-off number of about $182 million. So if you add to that, it's about $564 million of our $882 million provision. So, Barb, you want to talk about the risk rating?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

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Well, I think we've covered that. The point I'd make is though that there is – it's hard to distinguish between deterioration and the credit portfolio and changes in the economic environment because one effectively negates the other.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

Yeah.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

I think it visually represents what is just overall our assumption's based upon the current stress environment that we're in.

Matt O'Connor
Analyst, Deutsche Bank Securities, Inc.
Q

All right. That was helpful. Thanks for going through that again.

Operator: Your next question is from Peter Winter of Wedbush Securities.

Peter J. Winter
Analyst, Wedbush Securities, Inc.
Q

Hi. Good morning.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Hi, Peter.

Peter J. Winter
Analyst, Wedbush Securities, Inc.
Q

Good morning. I was just wondering, when I look at the DFAST results, it seemed like they weren't as strong as they should have been on PPNR. And is there anything that the Fed is missing or anything that you can do to address that with the Fed especially when it comes to the stress capitals [ph] out there (00:51:46)?

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

So, Peter, we – as we laid out in our prepared comments, we have a unique benefit of our forward-starting hedges that we had put in place a couple of years ago, but they didn't become effective until the first quarter of this year for a piece of them. The second quarter had another piece. And then the third quarter, there's one more step-up and you can see that in the chart that we've put in the slide deck.

Because that benefit wasn't in our run rate, we don't believe we got the full benefit of that in our PPNR estimation in that last DFAST. As a matter of fact, our PPNR which we believe should outperform our peer group, in that test, so it was in the middle of the peer – it was a median part of the peer group. So we're in having discussions on how that can be reviewed by them differently. Obviously, we're going to go through some form of a stress test this fourth quarter. They will have the knowledge, obviously of our derivatives and how they come in to protect our PPNR in the stressful times especially in a low-rate environment. So let's see what happens as they continue to

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evaluate both the SCB, so it's a preliminary SCB. The final won't be out till August 31. And then on top of that, we'll have the fourth quarter stress test of some type.

Peter J. Winter
Analyst, Wedbush Securities, Inc.

Q

All right. Thanks.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you.

Operator: The next question is from Jennifer Demba of SunTrust.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Good morning, Jennifer.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Good morning. A question on deposit service charges, they were $131 million in second quarter, down from $178 million. What kind of run rate are we looking at for that line item in future quarters and how much of fee waivers are coming back in?

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

A

Yeah, Jennifer. So, we tried to give a little bit of guidance. So, let me roll it forward from the first quarter. If you recall, spend was down quite a bit on the consumer side and that we were concerned if that stayed at that level, it was going to cost us about $25 million a month between service charges in card and ATM fees. In our prepared comments, because of the spend coming back, in particular on debit card usage, that number is down to $10 million to $15 million per month at this current level.

Now, in the month of June, we started to see that pick up a bit, but still not to the level that we had seen pre-crisis. A big driver of that is the amount of stimulus that's still sitting in the deposit accounts of our customers. Therefore, you don't have [ph] NSF (00:54:33) fees, for instance, coming through, and you don't have a credit card interchange coming through. So right now, we're guiding to $5 million – $10 million to $15 million per month from the pre-March numbers that you really ought to think through as you model.

Jennifer Demba
Analyst, SunTrust Robinson Humphrey, Inc.

Q

Thanks so much.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

Thank you.

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Operator: Your next question is from Saul Martinez of UBS.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning, Saul.

Saul Martinez
Analyst, UBS Securities LLC
Q

Hey. Good morning. Hey, I wanted to go through the dividend math a little bit in a little bit more detail. And I know you guys said, based on your best estimates and realizing there's a lot of uncertainty here, you should be able to pay your dividend. But if the Fed does extend the dividend cap into the fourth quarter, by my calculation, you guys would have to do about $260 million of the net income for preferreds in the third quarter to keep your dividend at $0.16 a share. And if it's extended into next year, then that's just even more difficult as 2019 rolls off because presumably that goes up closer to $300 million. So I guess, what I want to get a better sense for is that, when you say that you're confident in meeting your dividends, are you basically saying that you're confident that you'll be able to meet that kind of net income threshold over the next couple of quarters?

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

That's what we're saying.

Saul Martinez
Analyst, UBS Securities LLC
Q

Okay. All right. That's good. I'll be respectful of the one question rule. So thank you.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

Okay.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Thank you, Saul.

Operator: Your next question is from Dave Rochester of Compass Point.

David Rochester
Analyst, Compass Point Research & Trading, LLC
Q

Hey, good morning, guys.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning.

David Rochester
Analyst, Compass Point Research & Trading, LLC
Q

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Hey, given all the work you guys have done with the more at-risk book and those credits under stress which drove a lot of these downgrades and the quantitative reserve builds you guys have here. Was just wondering what the reserve ratio is that you have on that at-risk book? Or what you're seeing as the overall potential loss content there?

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.
A

Yeah. This is Barb, and right now, we would have a reserve ratio on that at-risk book of about a little over 7%. And then, if you look at some of the subsectors, energy as an example of the high risk segments that we point out at 10.5% to give you a sense, restaurants over 7%. So we think, we have a pretty healthy reserve on it.

David Rochester
Analyst, Compass Point Research & Trading, LLC
Q

Great. All right. Thanks, guys. Appreciate it.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Thank you.

Operator: Your next question is from Christopher Marinac of Janney Montgomery Scott.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning.

Christopher Marinac
Analyst, Janney Montgomery Scott LLC
Q

Thanks. Good morning. I just want to follow-up on some points that Barb was making earlier. So given the changes on the business criticized and the reserve build this quarter, what has to change to see if that further deteriorate? Do you feel like you're ahead of that with the changes that you made this quarter?

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.
A

Yeah. I would say we're certainly on top of it. And of course, the [indiscernible] (00:57:41) as we all know is what's going to happen in the economy. So, our best view of the economy is what's incorporated into what our thinking is. If all of a sudden we get a second wave that comes in and it closes everything down, there's going to be some more pain. But based on what we know today, I'm back to – yeah, I'm really confident on it.

As I've said, we've gone through. We've had the discussions. They're not a one-and-done discussion. They are an ongoing discussion. We have these meetings set up with Ronnie's team again and we have them all in there, we have credit in there, we spend hours going through it. So again, that gets back to giving me that level of confidence that there's nothing that's happening that we're not talking about or seeing and more importantly, reflecting in our thoughts around what are we going to call a criticized loan or a classified loan, an NPL or a charge-off for that matter.

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John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Yeah. I think the other caveat is we really – the level of federal government relief is unprecedented and it is very difficult for us to apply any sort of modeling to that. And so, depending upon whether the relief is extended or not, what that looks like certainly is a factor as we look forward. But that, of course, would influence, I think, that the economic conditions that we're currently assuming as well. So it is an unusual time. But as Barb said, we feel like we're on top of our reserving and credit issues.

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.
A

Absolutely.

Christopher Marinac
Analyst, Janney Montgomery Scott LLC
Q

Great. Thanks for the additional color. Appreciate it.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Yeah. Thank you.

Operator: The next question is from Vivek Juneja of JPMorgan.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Vivek, good morning.

Vivek Juneja
Analyst, JPMorgan Securities LLC
Q

Hi. Morning. Thank you. Just a couple of clarifications around credit. You mentioned – I think David mentioned no more reserve build. David, am I to presume that your – and at the same time, you gave a guidance for net charge-offs to remain at second-quarter levels. So, two elements to that. Where are you expecting charge-offs? Where is the – in your line of sight that you've given this guidance, you're obviously expecting charge-offs in some categories, which are those? And then to your reserve point related to that, David, are you expecting provisions will at least match charge-offs? Are you presuming reserves to [indiscernible] (01:00:09) going to start to come down, so you're not starting to release reserves yet, right?

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

Well, let me start with your back part of the question, and then Barb will answer the first part. So the way CECL works is we're supposed to reserve for all losses in the portfolio at the balance sheet date based on all the factors that we can observe, economic indicators and the like. And so, if we do that right and portfolio – the economy doesn't change, there's no degradation in the credit metrics, loans aren't growing, then you wouldn't expect to have provision – you can't have provision necessarily equal to charge-offs. It's kind of whatever it takes to get the reserve to the level it needs to be at at the balance sheet date.

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So right now, we think we have it all. But as we did in the first quarter, the caveat we gave you then, we're going to give it to you now. We don't know what the economy is going to look like at September 30. But based on what we do know, even subsequent to closing of the books, the economy hadn't degraded materially from where we were when we set the reserve. So we're feeling better about that going into the third quarter which was different than going into the second.

So, Barb, you want to answer the...

[indiscernible] (01:01:31)

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.
A

Yeah. First part of the question, which is where are the charge-offs going to come from in our estimation based on the analysis that we've done, the conversations that we've had. Again, primarily from the two portfolios we've already talked about, energy and restaurant, we have to see the rest of that play out. There's going to be some retail and some hotel that could impact as well. But that's generally what I would size it up to.

Vivek Juneja
Analyst, JPMorgan Securities LLC
Q

Okay. Great. Thank you.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Thank you, Vivek.

Operator: Your next question is from Gerard Cassidy of RBC.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning, Gerard.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Good morning, John. How are you?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good. Thank you.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

I've got some questions on the forbearance part of the portfolio. One's a technical question on, are you accruing all the interest for those loans even though the customers that may not be paying versus the ones that are paying? And then the second part of the question is, have you had any conversations with the Fed on when they may go back to their more traditional stance on forbearance and on how banks have to carry the higher capital levels against those loans?

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And then the third part of the question is, once you go off forbearance, the Fed says, it ends with, say, second quarter of 2021 and you still got loans on forbearance. Will they immediately start going into a non-performing status, meaning being meaning 30 days past due? Or will you just immediately put them into non-accrual because they've already been in forbearance?

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

A

Gerard, this is David. I'll start with the first part. So when loans go into forbearance, we still accrue interest unless that loan was already on non-accrual status or it had – it didn't have the ability to pay all of its principal and net contractual principal and interest, in which case any payments that we were to receive, we actually write down the principal balance. That's our accounting policy. So for the most part, this type of forbearance that you're seeing, you can see the performance where people are still making their payments, but even if they're not – and they're not on non-accrual, we are, in fact, accruing interest on those. Do you want to talk about the second part?

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

The second part of the question is we've not had any conversations with the Fed about when they may change their guidance about how we work with customers in respect to the coronavirus. And their initial guidance gave examples including six-month periods of forbearance as examples of how we might consider working with customers and we really haven't had any guidance since then. The third part of your question, I think, was hypothetically what do we do if we get out 9 months, 12 months and a customer still can't pay, and Barb, do you want to talk about that?

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.

A

Yeah. I don't see a cliff at that point in time because what we're doing is with the process we have in place right now is we're taking all of that information we have in place today. The customers on deferral, that's one input point. We're looking at their cash flows. We're looking at a lot of other things to make the determination on the risk rating, which is why you're going to see customers who are paying that we may have sitting in the non-performing loan category or move to a criticized or classified category. So, we are making those risk rating changes not because of the deferral, but as I said, deferral's simply a point. So I don't see a huge cliff on any of that.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.

A

And, Barb, we're using the deferral as a leading indicator to go dig deeper, Gerard, into that relationship, not looking at trailing 12 months, but what the current information is today and what challenges that that relationship is facing. So we're – to Barb's point, we're calling it as we see it today.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.

A

Yeah. And I – this is David. I hate to pile on this, but it's important that people understand that we are – because you are given leeway on forbearance from a regulatory standpoint, if we believe it needs to be risk-rated in a certain way, we're doing that. So that's why you shouldn't see a cliff effect regardless of what the Fed says about how we can treat loans or TDRs or anything. We're calling that independently.

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John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Yeah.

Barbara I. Godin
Deputy Chief Risk Officer & Chief Credit Officer, Regions Financial Corp.
A

Exactly.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Thank you.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Thank you, Gerard.

Operator: Your final question is from John Pancari of Evercore.

John M. Turner, Jr.
President, Chief Executive Officer & Director, Regions Financial Corp.
A

Good morning, John.

Rahul Patil
Analyst, Evercore Group LLC
Q

Hi. This is Rahul Patil on behalf of John. I only have one question on the efficiency ratio. I believe it's like 2Q 2020, the efficiency ratio was around, adjusted basis, of 57.7%. You've talked about your willingness to look at expenses a little bit closely if the revenue environment is a challenge. Can you talk about how you're thinking about the efficiency ratio going forward? What sort of level is reasonable assuming that the current conditions kind of stay or persist to at least year-end? Because I know in the past you've talked about a mid-50%. I'm not sure if there's any update on that one.

David Jackson Turner, Jr.
Chief Financial Officer & Senior Executive Vice President, Regions Financial Corp.
A

Yeah. So, we still have that as our long-term goal to get our efficiency ratio down into the mid-50s. And then when we get there, we're going to be pushing it even harder. So we have a little bit of volatility obviously and revenue given the changing rate environment. We'll have a little bit of pressure on NII as we've mentioned just a minute ago for the next quarter. But when you have challenges on revenue, then you have to go back and work on expenses and that's part of our program.

So while you may see that percentage change a bit [ph] and you get (01:07:19) quarter-to-quarter, I think where we are right now is sustainable over time and perhaps working that way down over time as we continue to work on expenses and the benefits from further hedges that actually come into force in the third quarter will help us from a revenue standpoint.

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John M. Turner, Jr.

President, Chief Executive Officer & Director, Regions Financial Corp.

Okay. Well, if there are no further questions, we really appreciate your participation today. Thank you for your interest in our company. Have a good weekend.

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

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