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Regions Financial Corp. (RF)

Q2 2021 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 2021 earnings call. John and David will provide high level commentary regarding the quarter. Earnings documents, which include our forward-looking statement disclaimer, 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, Chief Executive Officer & Director, Regions Financial Corp.

Thank you, Dana, and thank you for joining our call today. We're pleased with our performance this quarter. And, importantly, we're beginning to see increased activity across our footprint that gives us a greater confidence for overall growth in the second half of the year.

Earlier this morning, we reported earnings of $748 million, resulting in an earnings per share of $0.77 per share. Credit quality at Regions and across the industry has demonstrated remarkable resiliency throughout the pandemic. Broadly speaking, since the pandemic began, I believe banks have done a tremendous job staying close to customers and supporting their needs by providing capital advice and guidance.

As I have begun to trap our footprint again and meet with customers, I see them gaining confidence in the economic recovery and in their own business plans. I've seen the strength of our markets firsthand. This, combined with the ongoing successful execution of our strategic plan, has positioned Regions well for growth as the economic recovery continues.

We remain focused on clients selectivity, risk-adjusted returns and capital allocation, all while making investments, particularly in talent and technology to support growth. For example, over the last year, we redesigned our mobile app and are continuing to make further enhancements to both our online and mobile platforms. With these tied to sales process, you can now apply for almost any consumer banking product online.

We're putting digital tools in the hands of our bankers and contact center associates, allowing customers to start a process in one channel and seamlessly transition to another. We now have e-signature capabilities across most of the franchise. As a result of all of these changes, year-to-date, digital sales were up 53% over the prior year.

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We have also leveraged artificial intelligence to build lead generation and next best action tools for our bankers. We're also utilizing artificial intelligence in our contact centers. Reggie, our virtual banker, is on pace to handle over a million customer calls this year.

Technology investments have also allowed nearly 100% of our contact center associates to work remotely, providing permanent cost saves from reductions in legacy Corporate space. In addition, over the last three years, we've increased mortgage loan originators by approximately 150 loans and we'll continue to add talent as we grow market share. We've also added approximately 80 client-facing associates across the Corporate Bank and Wealth Management with a particular focus on growth markets.

We've consolidated over 215 branches, while opening 75 de novo primarily within dense, fast-growing markets. These new branches have contributed almost 20% of our total rebuild checking account growth over the last three years.

We're also investing in products and capabilities to serve our customers. In Wealth Management, we deepened our expertise in the not-for-profit and health care space through the acquisition of Highland Associates. And we're working on a digital advisory solution with deployment targeted for late this year or early next. Last year, we purchased Ascentium Capital to help small businesses with their essential equipment needs and the platform has performed well throughout the pandemic.

On the Consumer side, we just announced an agreement to acquire EnerBank, the top five originator and the home improvement point of sale space, which we're really excited about. Going forward, we'll continue to look for bolt-on acquisitions that provide products and capabilities that are important to our customers.

Win some really great markets as reflected on the slide you see now. These markets coupled with our go-to-market strategy and aided by technology investments have helped us realize some really nice growth and consumer checking accounts. Our year-to-date account growth is nearly 3 times higher than our 2019 pre-pandemic rate for the same period. So, we have a really solid strategic plan that supports our goal of generating consistent, sustainable, long-term performance, and we have a proven track record of successful execution. We feel very good about our progress and believe we are really well-positioned to grow as the economic recovery continues to gain momentum in our markets.

Now, David will provide you with some details regarding the quarter.

David J. Turner, Jr.

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

Thank you, John. Let's start with the balance sheet. Average adjusted loans remain stable during the quarter, although adjusted ending loans increased 1%, confirming our view that loan growth should begin in the back half of the year. Although Corporate loans continue to be impacted by low utilization rates and excess liquidity, pipelines have now surpassed pre-pandemic levels. Production remains strong with new and renewed commitments increasing 33% compared to first quarter. And we believe utilization rates reached an inflection point during the quarter.

On a reported basis, average Corporate loans increased, while ending loans decline, reflecting an acceleration in PPP forgiveness late in the quarter. Through June 30, approximately 53% of total PPP loans have been forgiven, and we anticipate that reaching approximately 80% by year-end.

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Consumer loans reflected another strong quarter of mortgage production accompanied by modest ending growth in credit card. However, Consumer loans continue to be negatively impacted by runoff portfolios and further pay downs in home equity. Overall, we continue to expect full-year 2021 adjusted average loan balances to be down by low-single digits compared to 2020, although we expect adjusted ending loans to grow by low-single digits. With respect to loan guidance and the rest of our 2021 expectations, we're not including any impacts from our pending EnerBank acquisition.

So, let's turn to deposits. Although the pace of deposit growth has slowed, balances continue to increase this quarter to new record levels. The increase is primarily due to higher account balances. However, as John mentioned, we're also producing strong new account growth.

We are continuing to analyze probable future deposit behavior and, based on an analysis of pandemic-related deposit inflow characteristics, we currently believe between 20% and 30% of the deposit increases will likely persist on the balance sheet.

Broadly speaking, we think liquidity will normalize over time as the Fed becomes less accommodative. Reductions in their asset purchases will mitigate future liquidity increases in the system, which should curb further deposit growth.

Let's shift to the net interest income and margin, which remain a significant source of stability for Regions. Pandemic-related items continued to impact the NII and margin. PPP-related NII increased $3 million from the prior order. Cash averaged $23 billion during the quarter and, when combined with PPP, reduced second quarter reported margin by 50 basis points. Excluding excess cash and PPP, our adjusted margin was 3.31%, evidencing active balance sheet management efforts despite a near-zero short-term rate environment. The 9-basis-point linked quarter decline was mostly attributable to the purchase of $2 billion of securities and one additional day in the quarter, both of which support NII, at the expense of margin.

Similar to prior quarters, the impact on NII from historically low long-term interest rates was completely offset by balance sheet management strategies, a lower deposit cost, and higher hedging income. Lower LIBOR drove a $2 million increase from loan hedges and, at current rate levels, we expect roughly $105 million of hedge-related interest income each quarter until the hedge has begin to mature in 2023.

Since the beginning of 2021, we have repositioned a total of $6.3 billion of cash flow swaps and floors. We do not currently expect any further repositioning. However, this is continually evaluated in the context of a dynamic balance sheet.

Our current balance sheet profile allows us to support our goal of A consistent sustainable earnings growth. Specifically, we are positioned to benefit from higher middle tenure interest rates and increases in short-term interest rates in the future, while protecting the NII stability to the extent the Fed remains on hold longer than the market currently expects.

Importantly, the recent declines of longer maturity market yields have less of an impact on Regions' earnings potential as most of our fixed rate production has maturities of shorter than six years, a point on the curve that, on a relative basis, has fallen less.

With respect to outlook, we view the second quarter's NII to be the low point for the year. Over the second half and beyond, a strengthening economy, a relatively neutral impact from rates, and organic and strategic balance sheet growth are expected to ultimately drive NII growth.

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Before moving on, I want to highlight slide 17 through slide 19 in the appendix, which provides additional asset liability management information that, we think, will be helpful to investors.

Now, let's take a look at fee revenue and expense. Adjusted non-interest income decreased 6% from the prior quarter, but reflects a 5% increase compared to the second quarter of 2020. Capital markets returned to a normal run rate after experiencing record results in the prior two quarters. Looking ahead, we expect capital markets to remain a strong contributor generating quarterly revenue in the $55 million to $65 million range on average excluding the impact of CVA and DVA.

Mortgage income decreased quarter-over-quarter, primarily due to the gain on sale compression and hedge performance particularly around timing and market volatility. We believe pricing has stabilized and expects second half revenue to be fairly consistent with that recorded during the second quarter.

Wealth Management income increased quarter-over-quarter, reflecting strong production and favorable market conditions. Service charges also increased compared to the prior quarter, driven primarily by three additional business days. While improving, we believe changes in customer behavior, as well as customer benefits from enhancements to our overdraft practices and transaction posting, which we have highlighted in the appendix, are likely to keep service charges below pre-pandemic levels. We estimate 2021 service charges will grow compared to 2020, but remain approximately 10% to 15% below 2019 levels.

Card and ATM fees continue to benefit from increased economic activity in our footprint, reflecting strong growth, up 11% compared to the prior quarter, driven primarily by increased debit and credit card spend, both now exceeding pre-pandemic levels.

Given the timing of interest rate declines in 2020, combined with exceptionally strong non-interest income, we expect 2021 adjusted total revenue to be stable to up modestly compared to the prior year. But this will be dependent on the timing and amount of PPP loan forgiveness.

Let's move on to non-interest expense. While exceptionally strong performance, particularly in credit, is contributing to higher than anticipated other incentive compensation, adjusted non-interest expenses decreased 3% in the quarter, driven primarily by lower capital markets incentive compensation, payroll taxes, and legal and professional fees, partially offset by an increase in merit and marketing expenses.

We will continue to prudently manage expenses while investing in technology, products and people to grow our business. In 2021, we expect adjusted non-interest expenses to be stable to up modestly compared to 2020 with quarterly adjusted non-interest expenses in the $880 million to $890 million range. And we remain committed to generating positive operating leverage over time.

From an asset quality standpoint, we delivered strong performance as overall credit continues to perform better than expected. Reflecting broad-based improvement across most portfolios and recoveries associated with strong collateral asset values, annualized net charge-offs decreased 17 basis points during the quarter to 23 basis points. Nonperforming loans, total delinquencies and business services criticized loans all improved during the quarter. Our allowance for credit losses declined 44 basis points to 2% of total loans and 253% of total non-accrual loans. Excluding PPP loans, our allowance for credit losses was 2.07%.

The decline in the allowance reflects better than expected credit trends and a continued constructive outlook on the economy. The allowance reduction resulted in a net $337 million benefit to the provision. Our allowance

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remains above peer median as measured against period end loans or stress losses as modeled by the Federal Reserve.

Future levels of the allowance will depend on the timing of charge-offs and greater certainty with respect to the path of the economic recovery. Based on improved market conditions, we now expect full year 2021 net charge-offs to range from 25 basis points to 35 basis points.

With respect to capital, our Common Equity Tier 1 ratio increased approximately 10 basis points to an estimated 10.4% this quarter. And, based on the recent stress test results, our preliminary stress capital buffer requirement for the fourth quarter of 2021 through the third quarter of 2022 will be 2.5% and our Common Equity Tier 1 operating range remains 9.25% to 9.75%, with the goal of managing to the midpoint over time.

We repurchased 8 million common shares during the second quarter. However, we are temporarily pausing further share repurchases until the expected EnerBank closing date in the fourth quarter. We anticipate being back in the market in the fourth quarter and expect to manage CET1 to the midpoint of our operating range by year-end. Also, earlier this week, our board of directors declared a 10% increase to our quarterly common stock dividend to $0.17 per share.

So, wrapping up on the next slide are our 2021 expectations, which we've already addressed. In summary, we're very pleased with our second quarter results and are poised for growth as the economic recovery continues. Pre-tax pre-provision income remains strong. Expenses are well controlled. Credit quality is outperforming expectations. Capital and liquidity are solid. And we're optimistic about the pace of the economic recovery in our markets.

With that, we're happy to take your questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question is from Matt O'Connor of Deutsche Bank.

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

Good morning, Matt.

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

Good morning.

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

How are you?

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

Good. Can you just remind us the impact of capital from the pending deal? I'm just trying to think of the walk on CET1 from 10.4% to 9.5% by the end of the year.

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

I think you can – Matt, it's David. You can the purchase price, which is $960 million and that's the capital we're going to use. We'll pick up a little bit of balance sheet and equity with that. So, I mean, around that number, call it $1 billion, which is round numbers about a point.

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

Okay. That's helpful. And then, just talk about some of the underlying loan demand that you're seeing. You said some pockets of strength and, obviously, there's been some pickup in COVID cases, specifically in the Southeast, and have you seen any impact in terms of the behavior of that in recent weeks?

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

Yeah. So, maybe I'll start with the last question first. In our markets, when COVID originally impacted the economy, they were some of the last to close and the first to reopen, and we really have seen the benefits of that with increasing economic activity in our markets.

We also are operating in markets that are some of the least vaccinated. And so, we have been at risk of some recurrence of COVID. The Delta variant is having some impact on the population, but we've not seen it necessarily impact the economy yet.

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Loan growth has been broad-based. We're seeing increasing activity across virtually all of our markets. Growth has been across multiple segments, whether it be the small business, middle market, large corporate. And we're growing in many of our specialized industries businesses, like healthcare, technology, financial services, transportation. We're seeing growth in asset-based lending. And so, our pipelines have definitely expanded. As, I think, the point was made, they exceed levels that we were experiencing at this same time in 2019, and the needs are to support M&A activity, to support short-term working capital needs associated with the expansion in businesses, growth in commodity prices, and also increasingly, some fixed capital investment which, I think, is a very good sign and, frankly, is a green shoot we've been looking for.

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

Q

Okay. Thank you.

Operator: Your next question...

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

A

I should say on the – just on – as a follow-on, the Consumer side as well, we, obviously, had good mortgage production. We expect to begin to see some growth in card as the level of payments comes down and spend increases. So, that should be positive as well.

Operator: Your next question is from Jennifer Demba of Truist Securities.

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

A

Good morning, Jennifer.

Jennifer Demba
Analyst, Truist Securities, Inc.

Q

Good morning. Question on expenses, just wondering how much wage pressure you're seeing and how much you're seeing of potential poaching of your employees. I know there's a big war for talent out there right now.

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

A

Yeah. Jennifer, it's David. So, from an expense standpoint, you could see our numbers. We're controlling that very well. I think at the end of day, as we manage our human capital, it's providing a great place to work and we've received a number of awards on that front. We're obviously in this transition period post – or I guess, still in the middle of a pandemic, but starting to return to the office, we've been working the whole time really providing some flexibility for our workforce.

So, I think when you create opportunities like that, you have to pay people fair market value and we think we do that. And so, we haven't seen any big trends that have gone the other way. But we're cognizant of the fact that people have alternatives when we're working in a remote environment. And I think being able to adapt to that and have flexibility would be a way to deal with it. So, the answer, I guess, short answer is no, we haven't seen that yet.

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Jennifer Demba
Analyst, Truist Securities, Inc.

Q

Are you able to – at this point, are you able to quantify how much money you can save in the area of real estate by having a more flexible work environment or totally remote work environment for some of your employees?

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

A

We could do some math around that, Jennifer, but it's probably a little premature to do so. We're working with a number of different opportunities. So, for instance, in our contact center, we're 100% remote. And so, the question is will that remain that way? And if so, does that affect space over the long haul? That's just one example. There are going to be a number of those. I think we need to get a little more time under our belt. Certainly, it leaves you to believe that, in time, our square footage ought to come down and – but I just don't know that we can quantify that at this point.

Jennifer Demba
Analyst, Truist Securities, Inc.

Q

Okay. And one more question if I could on your newer branches, you mentioned the amount of deposit growth you've seen from newer branches over the last few years. What are the plans for new branches as you look ahead the next one or two years?

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

A

I think you're going to see us continue the trend that we have. We're going to consolidate branches when it makes sense. We're going to make investments in markets that we think where we build out our density. And so, you'll continue to see some new branches. The power of the new branches were really contributing disproportionately to our growth from those de novo branches. But we also have to acknowledge the fact that we do have investments in digital that are important as well.

So I think as we optimize our branch footprint, we're going to look for consolidation opportunities where we can take two-for-one or three-for-one branch consolidation where it makes sense in a given market to be as efficient as we can while maintaining access for our customers but don't want to have them travel too far to our branches. So, we're going to continue to optimize our retail network as you have seen us do over time.

Jennifer Demba
Analyst, Truist Securities, Inc.

Q

Thank you.

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

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

A

Good morning, Gerard.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

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Good morning, John. Good morning, David.

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

Good morning.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

David, can you share with us – when you think about you, guys, gave us some good data about the pressure that your liquidity is causing on your net interest margin even when you exclude the PPP loans, can you share with us what's a reasonable amount of money or size, I should say, that that liquidity should be? So, much more are you carrying today than you would be comfortable with the way your balance sheet is shaped today? And second, how long you think it's going to take for you to wean down to that level that you think is appropriate?

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

Let me start with the end, the second part of the question. So, as the fed continues to be less accommodative, I think that liquidity in the system will start to go the other way. We didn't expect the growth we had this past quarter, so it continues to come in. And of course, we have child care credits and things of that nature that will probably aid to the liquidity.

So, we're carrying on average about $23 billion sitting at the fed earning 15 basis points. We'd love to redeploy that in a more meaningful manner. But sitting here where we are with the 10-year and trying to invest in mortgage-backed securities is probably ill advised.

Normally, we had been – to draw that number had been, call it, $1 billion, maybe $2 billion in normal times. So, it's a tremendous number. We do think that the surge of deposits that we've had this year, $30-plus billion that we think, 20% to 30% of that will persist on the balance sheet as we've mentioned and have a higher beta on it. But, nonetheless, the question of timing really is centered on the economic recovery. And what the Fed does with its balance sheet in a lower rate environment, more accommodation means deposits linger longer. If, in fact, the economy continues to rebound and we get the virus under control and we start seeing a GDP growth and people putting their cash to work, then maybe we see it run out a little faster. So, it's just really, really hard to tell.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Very good. Thank you. And, John, you gave us some color about the outlook for loan growth. Maybe can you give us or elaborate a little further on that loan pipeline that you talked about? Can you share with us what the pull-through rate is? And I know, in terms of the loan pipelines, it can be as simple as your loan officers had a conversation with a potential client to somebody who has actually signed a contract with you, guys, and there's a line of credit established and, therefore, that's more likely to come through as a loan than the first contact. So, can you give us some color of the pipeline and how it looks compared to prior quarters and what do you think a pull-through rate should be?

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

Yeah, a great question, Gerard, and one, I asked Ronnie Smith just a few weeks ago because a lot of the outcome is a function of how the loan officer or the relationship manager assesses the opportunity when they put

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it in the pipeline. The good news is that our 75% probability pipeline were pulling through more than 90% of the opportunities that we believe we're going to win.

So one of the reasons you sense a little more confidence from us and our ability to grow is that we are seeing good opportunities and we believe, at least to this point, we're winning most of those good opportunities when we believe we have an opportunity to do that. So I feel good about pipeline management and the efforts that our teams are putting forth to win new opportunities.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Is the pipeline considerably higher in this quarter versus 1Q or 4Q or is it slightly higher?

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

A

It's a good bit higher than – it's slightly higher, I guess, than 1Q. We began seeing some momentum build toward the end of the first quarter. It is, as I recall, 30-plus percent higher than it was this time two years ago.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Great. Thank you.

Operator: Your next question is from John Pancari of Evercore ISI.

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

A

Good morning, John.

John Pancari
Analyst, Evercore ISI

Q

Morning. Also on the loan front, I wanted to ask about front-end production. Do you have some quantifications around how much that was up on a linked-quarter basis and then how much – where it compares versus pre-pandemic?

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

A

Yes. So new loan production in our Corporate Bank was up 23% linked-quarter. I don't have that number right in front of me, but I'll get it while we're here on a two-year look-back.

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

A

Yeah. So, the growth in total production...

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

A

New production is what I'm referring to...

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

Yeah.

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

...it's 23%.

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

Yeah. Total new and renewed was up 33%. But if you exclude PPP, quarter-over-quarter is up 54%.

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

That's right.

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

And how that compared to pre-pandemic, John, we'll look that up as we go through the call and come back to you.

John Pancari
Analyst, Evercore ISI
Q

Okay.

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

[indiscernible] (00:31:44) memory.

John Pancari
Analyst, Evercore ISI
Q

Yeah. No problem. And one other thing on that topic and then I have one other follow-up, is your line utilization at 39.5%, how does that compare to your normalized level?

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

Typically, we run 44%, 45%. So – and we're 400 basis points to 500 basis points shy of where we'd normally operate and 800-basis-point differential means $575 million, $600 million in loan growth.

John Pancari
Analyst, Evercore ISI
Q

Got it. Okay. And then, separately, I know you've indicated your service charges could remain 10% to 15% below 2019 levels. Part of that is the overdraft dynamic. Can we just confirm your overdraft fees annually, they total about $300 million annually? And then, secondly, where do you see that going as you see the continued change in behavior and maybe a little bit of governmental scrutiny around the overdrafts again?

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

Yeah, John. So, your number is reasonably close to that. I think everybody sit around that number. And our anticipation of all the things that we've done, our anticipation of customer behavior, our transparency we're providing, which is allowing customers to understand where they stand intra-day on things that we'll post to their account the following night of a given day, gives them more opportunities to take care of a negative account situation. So, we've tried to anticipate what all that is and our guidance on our service charge has been down 15%. It was down because of that. It was down because we were doing things to help our customers. We reduced our overdraft caps and things of that nature in a given day.

So, now, you've asked a question, what could happen? We don't know. We're trying to do what we think is the right thing and what the government or regulators do. We'll have to adapt and overcome if there's any change at all. So, I think our 10% to 15% below pre-pandemic is our best answer at the moment.

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

And I think I'd just add, John, that as we have provided our customers more tools to better manage their finances, we've seen NSF OD fees decline over time. So, if you look back 10 years and come forward to today, there's been an over 40% decline in NSF OD fees that we've recognized. So, call that, I guess, on average about 4% a year from customers just managing their finances better.

We've grown our customer base over that period of time so you'd have to assume there are fewer incidences of NSFs and overdrafts. And I think that that trend will continue. And as David said, we're prepared for that through growth and other fees associated with growth in our business whether it be debit card transactions associated with a high level of debit card activation and growth in checking accounts, growth in Wealth Management, capital markets, and other sources of mortgage, other sources of fee income.

John Pancari
Analyst, Evercore ISI
Q

Got it. All right. Thanks for taking my questions.

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

Thank you.

Operator: Your next question is from Betsy Graseck of Morgan Stanley.

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

Good morning, Betsy.

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

Hi. Good morning. How are you doing?

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

A

Good. Thank you.

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

Q

So, I wanted to dig in a little bit on the EnerBank acquisition strategy. I know that you have some nice slides in the back talking about what the activity is in your footprint. Could you give us a sense as to how the activity skews in the non-Regions branch footprint? And then, what are you going to bring to this business? How are you going to ramp this going forward?

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

A

Yeah. So, today, we estimate the marketplace is about $176 billion annual origination market across a couple of different categories of home improvement. EnerBank has been particularly active in HVAC and pools have a growing presence in solar. And we have been observing, participating in indirectly to the point-of-sale lending space for now six years or seven years, and have aspired to have the opportunity to have an origination vehicle, if you will. We think EnerBank provides that.

We built our consumer lending strategy around lending around the home, if you will. So, we've been investing in mortgage. We're making some improvements in our equity loan and line products. And we think EnerBank is the third leg of that lending around the home do with a focus on home improvement and point of sale lending to the consumer.

In terms of what we bring, we bring balance sheet. EnerBank's growth has been constrained to some extent by their willingness, if you will, the parent company's willingness to fund their growth. And we, of course, have significant liquidity and a balance sheet and a desire to continue to grow that business.

We bring banking products and services to EnerBank's customers, which we think we can more broadly deliver and deepen those relationships, which benefits EnerBank as well. And then which bring overall capacity and an existing customer portfolio that we think we can market in to across our footprint.

So we believe the combination really powerful. We think we can be a nice asset for growth and a nice set of products to offer to our existing customers. And at the same time, a nice group of customers to sell our products into to meet EnerBank's customer needs. It should be a good combination.

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

A

Well, I'd add as it relates to production. So 55% of their production is in our existing footprint, so 45% is not. And so, we're looking at continuing to build out and diversify throughout the country on this particular product.

One of the things that we bring that they did not have is, as you know, the yield is roughly 9% with 2.5 points and that's coming from the contractor or the dealer and the others is the customer. And so, if somebody takes out a loan and then refinances, we're going to be there. That's going to be our customer now that we have a mortgage opportunity for. So if that happens, those fees get accelerated. And so, whereas EnerBank would have received that. They wouldn't have gotten the benefits of the mortgage. We're going to be able to get that and the fees. So we just think it's going to be very powerful.

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The last piece of this I'll say is, as John mentioned, it's a large industry but it's incredibly fragmented where EnerBank only represents 1% of that production. And, we think, over time, we're going to be able to penetrate this market much deeper than what they've been able to do primarily because of our funding.

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

Q

Right. I mean, when you look at the filings, it looks like they were selling out half of their originations historically; and, obviously, you'd be able to retain that.

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

A

That's correct.

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

Q

The other question that I had is you mentioned that you are looking at more incremental M&A opportunities. And I'm wondering what gaps do you still have or what you're most focused on growing?

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

A

Well, we want to continue to add to some specific capital markets capabilities. We have a very good mortgage servicing rights group, and so, we're interested in potentially acquiring more mortgage servicing rights.

We want to continue to, as David said, potentially grow and expand what EnerBank is doing. We're thinking Wealth Management; there's some potentially some opportunities to gaining some additional capabilities there as well. So, fairly broad-based as we think about other opportunities to grow and diversify our revenue and to acquire capabilities to help us meet the customer needs.

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

Q

And the mortgage servicing rights piece, how does that fit in to customer needs? Can you just give me the strategic bullet point on it?

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

A

Well, it's a – we think it just continues to support the capabilities that we have and it continues to drive efficiencies through that particular unit. So, it's as much about benefits to the shareholder, I guess, as it is meeting customer needs.

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

Q

Okay. All right. Thanks.

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

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

A

Good morning, Ken.

Kenneth M. Usdin
Analyst, Jefferies LLC

Q

Hi. Good morning, guys. Hey just a follow-up on the swap book. David, you said that you don't intend to making any other changes to the book as is. And just wondering how you philosophically think about that against what's happened with the rate curve and the excess liquidity. I'll start with that.

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

A

Yeah. Ken, I think all the adjustments that we see right now we've made, but that we also had a caveat in there that this is a pretty dynamic environment. So, as circumstances change we'll also adapt and overcome. We've talked about – we think there's a misunderstanding on our swap book. We do have a long terms, five-year terms on our swaps. And as conditions change and we see an opportunity for rising rates, then you would expect us to take off some of that protection that we have for the low rate environment so that we can benefit as rates rise.

So, that being said, we are naturally asset sensitive more so than many banks because of our deposit base. And so, the repositioning of moving those notional amounts to a different period of time to help protect us when the economy actually rolls over the other way and the fed becomes more accommodative. So, it's very dynamic. What we want to do is make sure we have an appropriate interest rate risk program that lets us benefit regardless of what the rate environment is. And that's an everyday – we have a whole group of people. That's what they do every day. And so, we've made the changes we think necessary thus far, but we're going to continue to watch it.

Kenneth M. Usdin
Analyst, Jefferies LLC

Q

Understood. And just as a follow-up to that then, David, the $105 million benefit run rate that you mentioned, how far quarterly of a line of sight do you have on that level and when in 2023 does that start to drip a little bit as just the natural role? I know, obviously, kept in concert with hopefully by then rates have gone up as an offset.

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

A

Yeah. I mean that's the point. I'm glad you mentioned that. That's exactly the point we're trying to make. So, if you just looked at the hedge benefit of $105 million, I think we have – didn't we put that in the slide? If we didn't do it this time, we actually had a slide that show it drifting down lower as you go through 2023, but that's stat, that's based on today.

Over time, that can change because if we reposition certain derivatives, we're not going to be benefiting from the derivative, but we'll be benefiting because rates are higher on the rest of our loan portfolio. The purpose of the hedge was to protect us, not the dues, NII and margin. It was to protect us if rates stayed low, which they have done. And so, when you think about giving up, if you will, benefit from our derivatives because either their term comes or we terminate them, it's because we're winning on our whole portfolio that helps offset and then some for NII growth. Hopefully that makes sense.

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Kenneth M. Usdin
Analyst, Jefferies LLC

Q

It does. Okay. Thanks for that, David.

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

A

Let me go back to John Pancari's question on loan production. So, John, we – if you go back to the second quarter of 2019 and you compare that production level to what we just had, it's a little over 100%. So, a little bit more than double what that production was at that time. So, hopefully that gives you a little bit of context.

Operator: Your next question is from Bill Carcache of Wolfe Research.

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

A

Good morning.

Bill Carcache
Analyst, Wolfe Research LLC

Q

Thanks. Good morning, John and David. Following up on your comments around the enhancements through your overdraft practices, can you give a bit more color on whether you're combining those enhancements with a marketing message on your consumer-friendly practices so that hopefully those enhancements translate into greater retention and lower attrition?

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

A

We are. We're reaching out to customers, reaching out across our associate base, making sure that everyone understands the benefits we're providing and hopefully that translates into, frankly, customers beginning to increase the utilization of tools that we're providing. We're not seeing early – early we're seeing some nice pickup and alerts as an example, which I think is a key tool that customers can and will use to help them better manage their finances. We should be introducing our bank on product. It's been approved and should be live sometime later this quarter. And we think that's another enhancement that, when combined with the other changes we're making, will send a real positive message to our customers.

Bill Carcache
Analyst, Wolfe Research LLC

Q

Got it. Separately, following-up on EnerBank, can you give a bit more color on the cross-sell opportunity across the 10,000-plus contractor network? And sorry if I missed this, but over time, do you intend to extend the business model nationally outside of where EnerBank originates loans today or is there a reason you need to stay closer to your [indiscernible] (00:46:16)?

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

A

Well, I think they're originating loans across the country today and we don't intend to change that. The good news is that 55-plus percent of their originations are in our footprint and that makes some sense when they're financing

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HVAC and pools, swimming pools, you'd naturally think that a good bit of that activity is going to occur in the southeast and so, we'll continue to lean into that.

In terms of cross-sell, we're just beginning to have conversations with the leadership team there about how we'll go about it. But we have a similar effort underway, if you will, with Ascentium Capital and we're already beginning to see the benefits of that activity. So, we'll have a template of sorts with what we're doing with Ascentium and their customer base that, we think, we can leverage into the relationship with EnerBank.

Bill Carcache
Analyst, Wolfe Research LLC

Q

I see. I think I may have misread on slide 28. You guys have on the top right, the originations, LTM, and there are several states where there aren't any. And so, I just thought that that met only the ones that show – I think, I just may have misread that. So, they are...

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

A

Yeah.

Bill Carcache
Analyst, Wolfe Research LLC

Q

...originating across the country?

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

A

Yeah. And it's – think about it just as a function of product. So, back to the three primary products being HVAC, pool, and solar, those are largely going to be products that get originated across the Sunbelt and on the West Coast.

Bill Carcache
Analyst, Wolfe Research LLC

Q

Understood. And then, lastly on PPP, with the bulk of loans forgiven by the end of this year, can you give any color on the extent to which you think PPP helped deepened the relationship with your customers that participated in the program beyond having provided support for them during the pandemic? Just curious whether you think there's any future benefit from those deeper relationships?

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

A

I do. I mean, I would say the customers that I run into that, I mean, that was such an incredibly stressful time for customers, for bankers in the economy. There was so much uncertainty. And our ability to meet customer needs and to help almost 80,000 customers receive a loan through the PPP program had a huge impact on customers and on their employees.

We think that we supported saving of over 1 million jobs as a result of the loans that we made. And so, I think, we did generate a good bit of additional loyalty. Good news is our loyalty scores are already very high amongst our consumer and small business customer base. But, I think, our participation in the PPP program and the way we responded for customers ultimately did generate good bit of additional loyalty.

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Bill Carcache
Analyst, Wolfe Research LLC

Q

Got it. Thanks very much for taking my questions.

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

A

Good morning.

Christopher Marinac
Analyst, Janney Montgomery Scott LLC

Q

Thanks. John and David, I was curious if the EnerBank deal would have been as attractive as the excess liquidity wasn't as high because the excess liquidity kind of help justify that transaction.

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

A

I think – I'll let David speak to the finances. But just purely from a strategic perspective, as I said earlier, we've been participating through an indirect relationship, actually two indirect relationships we had. We've been participating in point-of-sale or unsecured lending to consumers on an indirect basis largely to support home improvement not entirely. And it has been our desire to find a way into that space as we've seen consumers migrate their borrowing from banks traditionally to these point-of-sale lenders. And so, we've had an interest.

We also, as I mentioned, are focused on lending around the home and meeting customer needs through three different product channels: first, mortgage; HELOC, HELOAN; and then third, this point-of-sale lending activity. So, we've been looking and interested for some time and we think EnerBank is a great opportunity for us, really well-run company. We like the team and the relationships they have. And so, I believe it would have been just as interesting to us. But, David, if you want to.

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

A

Yeah. Financially, it would – the fact that we had idle cash is incrementally beneficial, but we would have still done the transaction even with a debt financing, I mean, the return on capital, return on investment that we're going to experience and continuing to grow. And we think that, at the end of the day, what our investors really want us to do with our business and the capital we generate, instead of buying stock back and things of that nature, is to invest in the business and grow and to make smart acquisitions where you get a disproportionate return and you creating a product capability to serve existing customers and grow new ones that you can cross-sell to as we just talked about whether it'd be the 10,000 contractors or all the folks, individuals that have loans. So this was not done because of that. It was independent.

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Christopher Marinac
Analyst, Janney Montgomery Scott LLC

Q

That's helpful. Thanks for walking through that background. I appreciate it.

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

A

Sure.

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

A

Thank you.

Operator: Your final question is from Christopher Spahr of Wells Fargo Securities.

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

A

Good morning.

Christopher Spahr
Analyst, Wells Fargo Securities LLC

Q

Thank you. Good morning. So first, I'd like to give you – commend you on, actually, your good digital disclosures, it's one of the best amongst all regional banks. So my question is going to be tech-related. So what's your outlook for your $625 million tech budget given the opportunities to grow accounts and target specific customers, as well as like optimizing your contacts that are 100% remote? I don't think there's any other bank that's like that.

And then second, my follow-up would be at what point do these investments become self-funding and when do you expect to get there? Thank you.

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

A

Well, I will speak to the first part of the question. I'm not sure about the self-funding. I guess, it's – our hope is, over time, as we make investments, that the cost of computing comes down and we're able to continually make investments. We said we're spending about $625 million, as you pointed out. Roughly 10% of that is dedicated to cybersecurity and defending the bank and our customers. Approximately 48%, we said, is dedicated to keeping the bank going to maintaining operations and 42% support innovation and new ideas. And we're going to continue to make those investments. And, we believe, through doing things like improving our mobile app, through digitizing the account origination process, through giving our bankers, whether they're in the branches or our Commercial and Wealth RMs more digital tools to assist customers, e-signature capabilities across the footprint drives digital usage.

At the same time, we want to make sure that we're investing in capabilities that give customers more self-service options that allow them to use all of our channels and have the same great experience whether they're at an ATM, in a branch or using their mobile or online app or talking to the call center. That'll be really important to us as we continue to try to meet customer expectations for convenience and speed of transaction and more self-service options.

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So, I think as we make those investments, they create process improvements. They help us drive efficiencies and effectiveness consistent with our desire to continuously improve, and that generates more funding for a reinvestment in technology and innovation. And we believe that that model and we've proven that that model works over the last three-plus years and we expect it will continue to work as an important part of our strategic plan.

David J. Turner, Jr.

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

A

Yeah. Chris, I'll add. I think – so, we're spending 10% of our revenue on technology. We expect to grow revenue over time. And, as a result, technology spend will increase. You've asked a very good question and to the folks that work for Regions, I promise, I didn't have Chris plant this question because that's what we ask all the time is, if we're going to spend this kind of money, where is our return, when are you going to be on your own. And that's hard to answer, Chris, but certainly we challenge ourselves all the time to make sure every dollar that we spend is meaningful and that we're not just spend in technology, spend technology. What benefit does our customer get and what benefit do our shareholders get from this spend? And it's a continual challenge and I think we're in pretty good position for that, but it's hard to give [indiscernible] (00:55:33) project exactly when that's self-sustaining.

Christopher Spahr

Analyst, Wells Fargo Securities LLC

Q

Great. Thank you very much.

John M. Turner

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

That's it? Okay.

Operator: There are no other questions...

John M. Turner

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

Great. Well, I'll just close by acknowledging the great work of our teams. These are still somewhat uncertain times and I think our teams remain focused on the things that we can control, particularly focused on taking care of our customers. And I think that those benefits are beginning to appear in our results. So, I appreciate the work our teams have done. Thank all of you who participated today for your interest in Regions. Have a great weekend.

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

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