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Regions Financial Corp. (RF)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to Regions Financial Corporation's Quarterly Earnings Call. My name is Natalia, and I will 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, Natalia. Welcome to Regions' fourth quarter 2021 earnings call. John and David will provide high-level commentary regarding the quarter. Earnings' documents, which include our forward-looking statement disclaimer and non-GAAP information, are available in the Investor Relations section on our website. These disclosures cover our presentation materials, prepared comments, and Q&A.

I'll now turn the call over to John.

John M. Turner

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

Thank you, Dana, and good morning, everyone. We appreciate you joining our call today. We're very pleased with our fourth quarter and full-year results. We achieved a great deal despite a challenging interest rate and operating environment. Earlier this morning, we reported full-year earnings of $2.4 billion and record pre-tax pre-provision income of $2.7 billion.

Despite continued economic uncertainty, we remain focused on what we can control and our efforts are paying off. We grew consumer checking accounts by 3% and small business accounts by 5%. Notably, our 2021 net retail account growth exceeds the previous three years combined and represents an annual growth rate that is 3 times higher than pre-pandemic levels. We increased new corporate banking group loan production by approximately 30% and generated record Capital Markets revenue.

Through our enhanced risk management framework, we delivered our lowest annual net charge-off ratio since 2006. We made investments in key talent and revenue-facing associates to support strategic growth initiatives. We continue to grow and diversify revenue through our acquisitions of EnerBank, Sabal Capital Partners, and Clearsight Advisors. We successfully executed our LIBOR transition program to ensure our clients were ready to move to alternative reference rates. We continue to focus on making banking easier through investments in target markets, technology and digital capabilities. We've surpassed our two-year $12 million commitment to advanced programs and initiatives that promote racial equity and economic empowerment for communities of color.

Before closing, we're extremely proud of our achievements in 2021, but none of these would have been possible without the hard work and dedication of our nearly 20,000 associates. The past year posed unique challenges as we continue to transition to our new normal, both on a personal and professional level. Despite continued uncertainty, our associates remain steadfast. They continue to bring their best to work every day, providing best-in-class customer service, successfully executing our strategic plan and maintaining strong risk management practices, all of which contributed to our success.

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In 2022 and beyond, we'll continue to focus on growing our business by making investments in areas that allow us to make banking easier for our customers, all while continuing to provide our associates with the tools they need to be successful. We will make incremental adjustments to our business by leaning into our strengths and investing in areas where we believe we can consistently win over time.

As announced earlier this week, a key priority in 2022 will be additional comprehensive changes to our NSF and overdraft policies which are detailed in the appendix of our presentation. These changes represent a natural expansion of our commitment to making banking easier for our customers and complement the enhanced alerts, time order posting process, as well as our Bank On certified checking product we launched late last year. It's important to note that the financial impact of these enhancements have been fully incorporated in our total revenue expectation for 2022.

Again, we're pleased with our results and have great momentum as we head into 2022. Now, David will provide you with some select highlights regarding the quarter.

David Jackson Turner, Jr.

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

Thank you, John. Let's start with the balance sheet. Including the impact of acquired loans from the EnerBank transaction, adjusted average and ending loans grew 6% and 7%, respectively, during the quarter. Although business loans continue to be impacted by excess liquidity, pipelines have surpassed pre-pandemic levels. And encouragingly, we experienced a 240-basis-point increase in line utilization rates during the fourth quarter. In addition, production remained strong with line of credit commitments increasing $4.7 billion year-over-year.

Consumer loans reflected the addition of $3 billion of acquired EnerBank loans, as well as another strong quarter of mortgage production, accompanied by modest growth in credit card. Looking forward, we expect full-year 2022 reported average loan balances to grow 4% to 5% compared to 2021.

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 includes the impact of EnerBank deposits acquired during the fourth quarter, as well as continued growth in new accounts and account balances. We're continuing to analyze our deposit base and pandemic-related deposit inflow characteristics in order to predict future deposit behavior.

Based on this analysis, we currently believe approximately 35% or $12 billion to $14 billion of deposit increases can be used to support longer-term asset growth through the rate cycle. Additional portions of the deposit increases could persist on the balance sheet, but are likely to be more rate sensitive, especially later in the Fed cycle.

While we expect the portion of surge deposits to be rate sensitive, you will recall that the granular nature and generally rate insensitive construct of our overall deposit base represents significant upside for us when rates do begin to increase.

Let's shift to net interest income and margin. Net interest income increased 6% versus the prior quarter, driven primarily from our EnerBank acquisition, favorable PPP income and organic balance sheet growth. Net interest income from PPP loans increased $8 million from the prior quarter, but will be less of a contributor going forward. Approximately 89% of estimated PPP fees have been recognized.

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Cash averaged $26 billion during the quarter; and when combined with PPP, reduced fourth quarter's reported margin by 51 basis points. Our adjusted margin was 3.34%, modestly higher versus the third quarter. Excluding the impact of a large third quarter loan interest recovery, core net interest income was mostly stable as loan growth offset impacts from the low interest rate environment. Similar to prior quarters, net interest income was reduced by lower reinvestment yields on fixed rate loans and securities. These impacts are expected to be more neutral to positive going forward.

The hedging program contributed meaningfully to net interest income in the fourth quarter. The cumulative value created from our hedging program is approximately $1.5 billion, roughly 90% of that amount has either been recognized or is locked in the future earnings from hedge terminations. Excluding PPP, net interest income is expected to grow modestly in the first quarter, aided by strong fourth quarter ending loan growth, as well as continued loan growth in the first quarter, partially offset by [indiscernible] (08:53).

Regions' balance sheet is positioned to benefit meaningfully from higher interest rates. Over the first 100 basis points of rate tightening, each 25-basis-point increase in the federal funds rate is projected to add between $60 million and $80 million over a full 12-month period. This includes recent hedging changes and is supported by a large proportion of stable deposit funding and a significant amount of earning assets held in cash when compared to the industry.

Importantly, we continue to shorten the maturity profile of our hedges in the fourth quarter. Hedging changes to-date support increasing net interest income exposure to rising rates, positioning us well for higher rates in 2022 and beyond.

In summary, net interest income is poised for growth in 2022 from balance sheet growth and the higher yield curve in an expanding economy.

Now, let's take a look at fee revenue and expense. Adjusted non-interest income decreased 5% from the prior quarter, primarily due to elevated other non-interest income in the third quarter but did not repeat in the fourth quarter. Organic growth and the integration of Sabal Capital Partners and Clearsight Advisors will drive growth in Capital Markets revenue in 2022.

Going forward, we expect Capital Markets to generate quarterly revenue of $90 million to $110 million, excluding the impact of CVA and DVA. Mortgage income remained relatively stable during the quarter; and while we don't anticipate replicating this year's performance in 2022, mortgage is expected to remain a key contributor to fee revenue, particularly as the purchase market in our footprint remains very strong.

Wealth management income increased 5% driven by stronger sales and market value impacts, and is expected to grow incrementally in 2022. Seasonality drove an increase in service charges compared to the prior quarter. Looking ahead, as announced yesterday, we are making changes to our NSF and overdraft practices which along with previously implemented changes will further reduce these fees.

NSF and overdraft fees make up approximately 50% of our service charge line item. These changes will be implemented throughout 2022; but once fully rolled out, together with our previous changes implemented last year, we expect the annual impact to result in 20% to 30% lower service charges revenue versus 2019. Based on our expectations around the implementation timeline, we estimate $50 million to $70 million will be reflected in 2022 results.

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NSF and overdraft revenue has declined substantially over the last decade. And once fully implemented, we expect the annual contribution from these fees will be approximately 50% lower than 2011 levels. Since 2011, NSF and overdraft revenue has decreased approximately $175 million, and debit interchange legislation reduced card and ATM fees another $180 million. We have successfully offset these declines through expanded and diversified fee-based services. And as a result, total non-interest income increased approximately $400 million over this same time period.

Through our ongoing investment in capabilities and services, we will continue to grow and diversify revenue to overcome the impact of these new policy changes. We expect 2022 adjusted total revenue to be up 3.5% to 4.5% compared to the prior-year, driven primarily by growth in net interest income. This growth includes the impact of lower PPP-related revenue and the anticipated impact of NSF and overdraft changes.

Let's move on to non-interest expense. Adjusted non-interest expense has increased 5% in the quarter. Salaries and benefits increased 4%, primarily due to higher incentive compensation. Base salaries also increased as we added approximately 660 new associates, primarily as a result of acquisitions that closed this quarter. The increased head count also reflects key hires to support strategic initiatives within other revenue-producing businesses.

We have experienced some inflationary pressures already and expect certain of those to persist in 2022. If you exclude variable-based and incentive compensation associated with better-than-expected fee income and credit performance, as well as expenses related to our fourth quarter acquisitions, our 2021 adjusted core expenses remained relatively stable compared to the prior year.

We will continue to prudently manage expenses while investing in technology, products and people to grow our business. As a result, our core expense base will grow. We expect 2022 adjusted non-interest expenses to be up 3% to 4% compared to 2021. Importantly, this includes the full-year impact of recent acquisitions, as well as anticipated inflationary impacts. Despite these impacts, we remain committed to generating positive adjusted operating leverage in 2022.

Overall credit performance remained strong. Annualized net charge-offs increased 6 basis points from the third quarter's record low to 20 basis points, driven in part by the addition of EnerBank in the fourth quarter. Full-year net charge-offs totaled 24 basis points, the lowest level on record since 2006. Non-performing loans continued to improve during the quarter and are now below pre-pandemic levels at just 51 basis points of total loans.

Our allowance for credit losses remained relatively stable at 1.79% of total loans, while the allowance as a percentage of non-performing loans increased 66 percentage points to 349%.

We expect credit losses to slowly begin to normalize in the back half of 2022, and currently expect full-year net charge offs to be in the 25-basis-point to 35-basis-point range. With respect to capital, our common equity Tier 1 ratio decreased approximately 130 basis points to an estimated 9.5% this quarter.

During the fourth quarter, we closed on three acquisitions which combined absorbed approximately $1.3 billion of capital. Additionally, we repurchased $300 million of common stock during the quarter. We expect to maintain our common equity Tier 1 ratio near the midpoint of our 9.25% to 9.75% operating range.

So, wrapping up on the next slide are our 2022 expectations which we've already addressed. In closing, the momentum we experienced in the fourth quarter positions us well for growth in 2022, as the economic recovery continues. Pre-tax pre-provision income remains strong. Expenses are well controlled. Credit risk is relatively

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benign. 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.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] [Operator Instructions] Your first question is from the line of Erika Najarian with UBS.

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

A

Good morning, Erika.

Erika Najarian
Analyst, UBS Securities LLC

Q

Hi. Good morning. So, just going to – I actually didn't expect to ask this question, but the feedback that I got from investors in terms of the performance today, obviously, your outlook is quite upbeat, is that the tangible book dilution from the deals that you announced – rather closed in the fourth quarter surprised? And David, I'm wondering if you could share with us sort of the earn-back period you expect for these deals on tangible book value.

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

A

Well, we look at several factors, not just tangible book value. We look at diversification of revenue. We look at return on investment. Because when you – the alternative is buying your stock back, which also has a reduction in tangible book value. So, you're trying to look at the trade-off between how you put your capital to work. And frankly, I can't even remember what the payback was.

If we were looking at a bank acquisition, that's a little different, where we would expect a payback period of three years or less. But in this case, we're looking at diversification and being able to grow and the return on that investment is higher than the return we would have had if we would've bought our shares back.

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

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

Q

Hi. Good morning.

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

A

Good morning, Betsy.

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

Q

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A couple questions. First, on the announcement that you made yesterday on the changes to the overdraft insufficient funds fees. I know you sized it for 2022. Could you give us a sense as to – if that were to go in full year full on, what that level would be because obviously as we think into 2003, we need to understand how you're thinking about an annualized impact would be looking like.

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

Yeah. So, the guidance we provided, Betsy, is if you go back to 2019, take the total service charge revenue, the impact is going to be somewhere between 20% and 30% of total service charge revenue based on 2019 revenue once all the changes are implemented and annualized.

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

And that includes all of the things we already have done, too. So, it's a cumulative number. So, if you go back to that, you can calculate – and round numbers will be half – we're going to have half to maybe slightly more than that done in 2022. And so, it – in double at for close proximity of what the total would be.

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

And when you say the service charges from 2019, you're talking about the service charges from 2019 in your income statement, not what shows up as regulatory like overdraft?

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

That's correct.

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

Regulatory filing.

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

That's correct.

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

Right.

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

Okay.

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

And we think about it that way...

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

Q

The, you're going back...

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

A

...because, I mean, ultimately, all these fees are associated with the consumer business. And as we think about how we overcome that loss of revenue, it is through growth in consumer checking accounts, additional activity, debit card usage, debit card fees, other things that come with that. And as David has pointed out earlier, if you go back to 2010-2011 timeframe and come forward, we've been able to significantly grow non-interest revenue while overcoming the loss of revenue associated with Reg E and other changes. We expect the same will be true as we look forward relative to the changes we're making here.

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

A

And Betsy, just to help you out a little. If you go into our public filings and our Supplement 2019, our service charge number was $729 million, it's off that number.

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

Q

Right. Right. Okay. I was just going to confirm that. All right. Great. Thank you. And then, a follow-up question here just on how you're thinking about the Sabal acquisition and how that's going to feed into not only the income statement I heard you talk about, it's in the Capital Markets revenue line, but maybe help us understand, is there any balance sheet impact here and the expectation that you have to grow this business from where it is today?

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

A

Yeah. So, I would say, the balance sheet impact will be modest. We'll have an opportunity to develop relationships that might lead to our providing credit to customers and/or opening deposit relationships. We expect that to be true for sure. The primary benefit we derived from Sabal is the capabilities we have – permanent placement capabilities that we ultimately end up with. I think we're one of four or five banks in the country that will have a complete array of real estate permanent placement products, whether it be a Fannie license, Freddie licenses for large and small [ph] Dow or (23:17) CMBS capabilities.

We can bank our real estate customers' needs across the spectrum. And as we've transitioned from the Great Recession to today, we built, I think, a really solid real estate business. Real estate permanent placement revenue in 2021 will exceed $60 million. That's from zero in 2014 effectively. So, we've been building that business around regional and national real estate developers, really strong balance sheets, good liquidity and access to capital. The portfolio has performed very, very well. And we think this gives us an opportunity to extend those relationships and drive additional profitability.

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

Q

And there's been some – pretty recently, some significant uptick in that demand for that product, right?

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

A

Yes. And again, I think if you just look at the multifamily market and – it's awfully good. And now, those developers who like to build and hold want access to both the Fannie products and the Freddie products from time to time. And we've again found that to be a great source of revenue and a wonderful way to build stronger, deeper relationships with that customer segment.

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

Q

Okay. Thank you.

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

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

A

Good morning, John.

John Pancari
Analyst, Evercore ISI

Q

Good morning. On the loan growth front, I want to see if you can maybe give us a little more color on the 4% to 5% growth expectation you have for the year. And maybe if you can unpack it by giving us a little bit of color on the growth you expect for commercial and CRE and consumer, and how that could play out for the year. Thanks.

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

A

Yeah. John, it's David. So, first thing we have to overcome, it depends on if you're looking at it on the average which is where are the 4% to 5%. First thing you have to do is overcome PPP average which is about $2.7 billion, so put that in your model Then, if you look at areas where we can grow, clearly, we're going to get benefit of EnerBank having a whole year of EnerBank along with its growth that we expect. And so, that's a big driver of our averaging, mortgage ought to have a – may not have as much production as we have in 2021 for 2022, but we still believe we'll grow the balance sheet quite nicely there.

We expect credit card to continue to grow. And then, on commercial, even after you consider overcoming the PPP run-off on average at $2.7 billion, we think we can still grow that on top of it. As we look at the industries that we were particularly strong in in 2021 in the commercial space, financial services, health care, transportation, our asset-based lending, homebuilder, and to a lesser degree, technology, those are areas that we did see growth in, quite nice growth and expect to continue into 2022. And it's been geographically diverse as well.

John Pancari
Analyst, Evercore ISI

Q

Right. Okay. All right. Thanks. And then, separately, on the operating leverage expectation, based upon your guidance, you're looking for about 50 basis points [indiscernible] (26:58) operating leverage. Can you just talk to us about how – if Fed hikes may be proved to be less than expected, is that 50 basis points operating leverage still attainable? Do you still have levers to pull to be – to basically generate that despite any move by the Fed?

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

A

Well, it certainly makes it harder. But as we've always said, our goal is to generate positive operating leverage over time. And if our revenue grows in there, then we double down on expense management, and we obviously didn't get there this year nor did anybody else that I'm aware of. But we believe there's a reasonable path to that. And that's why we gave you the guidance. It showed you that roughly 50 basis points or more. And we have things we can do during the year that can help us get there. But yeah, rates not coming in at the pace we think or as many as we think will put pressure on that calculation. But we wouldn't give up on it just because of that.

John Pancari
Analyst, Evercore ISI

Q

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

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

Bill Carcache
Analyst, Wolfe Research LLC

Q

Thank you. Good morning. Just following up on the commentary around the positive operating leverage, I was hoping you could frame a little bit more the – how much variability there is around that 3% to 4% increase that you have in your outlook for expenses as those rate hikes begin to flow through. The forward curve reflects four hikes next year, but some are expecting more than that. So, how does the number of hikes, I guess, to the extent that we get more – influence the expense line. And does that 3% or 4% outlook hold? And on top of that, it would be great if you could also discuss your confidence level and being able to control the expense base such that you continue – you still achieve that positive operating leverage even under different inflation scenarios.

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

A

Well, you have a lot up there. So, let me see if I can help you out. So, on the expense side, the 3% to 4%, a large portion of that – a substantial portion of that was related to the acquisitions that we had. So, we closed on three deals in the fourth quarter, one of them right at the end of the year. So, we'll have a full-year run rate on all of those coming through. And that's the biggest single driver of the 3% to 4%. If you go back and look at our compound annual growth rate on expense management, we've actually done a pretty good job of controlling our expenses, and we don't do that in just one area, but at salaries and benefits and furniture, fixtures and equipment and occupancy and vendor spend. All of those things, we are all over, and John has this – our continuous improvement program is still going where we're looking to improve processes each and every day, leveraging technology to help us control our expense load.

So, I think, in terms of the revenue side, we have four baked into our guidance that we just gave you, four 25 basis points of moves each quarter. So, on average, you get two during the year, and it depends on will we get 25 basis points or will be more than that. We'll be more than four or less than four. I mean, you have to – we've told you in our guidance that each 25 basis points is $60 million to $80 million for us, so you can put your model and kind of work with that.

But back to the question earlier, I think from John Pancari, in terms of operating leverage, we are committed to generating positive operating leverage over time. And when things get more challenging, we'll do what we can to manage expenses. So, I'll leave it at that.

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Operator: Your next question is from the line of Ebrahim Poonawala with the Bank of America.

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

Good morning, Ebrahim.

Ebrahim H. Poonawala
Analyst, BofA Securities, Inc.
Q

Good morning. I guess one just question, a follow-up on the overdraft. It's been a big overhang on the stock, and I get your guidance around the impact this year, David. But just talk to us, downside just the industry seems to be moving away from your – give us a sense of like the use case of why there's a subset of overdraft fees that needs to exist and why you feel or care what competitively and from a regulatory standpoint that that component of fees will be dependable on?

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

Well, so, as we put it in our guidance yesterday, we're eliminating NSF fees altogether.

Ebrahim H. Poonawala
Analyst, BofA Securities, Inc.
Q

Yes.

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

We still have overdraft fees for a service that we're providing, which is liquidity to our customer base. And they appreciate the ability to be able to have that liquidity in time of need. And there's a cost to that. And now, we've done some things. We've given alerts. We've changed our posting order. We're going to give small dollar loans. We're going to give you a paycheck up to two days available in some cases. And so, we're doing a lot of things to make it easier for our customers to bank with us and to understand where they stand at any point in time. But if they need that liquidity, we want to be there. We've limited our – we will be limiting our overdraft to no more than three per day, too, which is one of the strongest in the industry. So, we're doing a lot of things. We think that's a value play for our customers. So, they want that ability for that short-term liquidity at the cost that we charge for it.

Ebrahim H. Poonawala
Analyst, BofA Securities, Inc.
Q

Noted. And I guess just a separate question around loan growth. Apologies if I missed it. But talk to us about the EnerBank acquisition, what that means for growth, especially some of the non-footprint? I think half of EnerBank is outside of the core Region footprint. Give us a perspective in terms of the opportunity that you have there, both in terms of what EnerBank does today and how to scale that up.

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

Yeah. So, we acquired about $3 billion worth of loans right at the end of the – at the beginning of the fourth quarter. We'll get all that in our averaging numbers which is where our 4% to 5% growth is for next year. Their

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production had been about 1% of the industry, which equated to about $1.7 billion in terms of production, and that's what they were doing. And we think we have the ability to take that and ramp it up over time and have nice growth there.

We're excited about EnerBank and excited about the fact that our geographic expansion of that is outside of our core footprint. It brings us the ability to have more customers throughout the country, to do other banking services with as well, including small business contractors that offer products to consumers. So, it is a big portion of our growth expectation, and we couldn't be more excited about adding EnerBank and the people that work there to the Regions family.

Ebrahim H. Poonawala
Analyst, BofA Securities, Inc.

Q

Got it. Thanks for taking my questions.

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

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

A

Good morning, Ken.

Ken Usdin
Analyst, Jefferies LLC

Q

Hey. Good morning, guys. Another just follow-up on the expenses, David, can you help us understand of the 3% to 4% growth, what part of that is just organic growth? What part is actually coming from the acquisitions, getting into the run rate? And then, what are you doing in terms of like offsets in terms of continuous improvement type of efficiencies?

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

A

Yeah, Ken, as I mentioned earlier, the overwhelming majority of our growth is related to the acquisitions that we have. We've been able and will continue to control our core expenses by managing the things I talked about, managing salaries and benefits and head count and our square footage whether it be branch or office square footage. When you manage your head count, you manage the number of computers you have to have. It's vendor spend. It's our procurement group really ensuring that from a demand management standpoint that people that are asking for vendors and third-party services really need them and when we have to have them, making sure that we get the best price for the services that we're getting.

That's ongoing. That's part of our continuous improvement program. And you couple that with leveraging technology and taking out processes that we have, we're not finished there. Now, we have to create opportunities to reinvest. So, embedded in the 3% to 4% are the investments that we're making in people and our certain markets that we have, that we see opportunities for growth there. We invest in technology, the people, and services to help us there. So, all that's embedded in the numbers that we've given you. But cutting to the chase of the 3% to 4%, the vast majority of that is related to the acquisitions that we announced.

Ken Usdin
Analyst, Jefferies LLC

Q

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Yeah, understand. And I apologize, I missed that comment earlier. I'm going to follow up separately, David, then on the – just on that [indiscernible] (36:57). You terminated a little bit more this quarter. Just want to understand like what percentage of that book is now kind of locked out from either you – that you've terminated or you understand the maturity schedule and we see from your – that color, NII slide, what that expected trajectory is like. So, I don't think there's much change. But can you let us know if there's anything different in terms of how you're viewing that portfolio going forward? Thank you.

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

A

Yeah. Ken, so we continue to kind of read the tea leaves and where the Fed is going and the market with regards to rates. So, we took some of our protection off. It unwinds this summer, so we have a little bit more asset sensitivity that comes in in the second half of the year. But we have to continue to monitor that because it's important. It's important for us to make sure that we have the proper sensitivity when we expect rates to go, and we do. And now, it's just timing. A month ago, maybe a rate increase or two. Other day, it's four. This morning, there are people talking about maybe it will only be a couple. So, I mean, there's a – this is very volatile and we're trying to do the best we can to anticipate where those rate moves are going. And we've locked in a good portion of our fair value, if you will, of our hedge portfolio over half. So, I think that we're in good shape. We can terminate some of those quickly if we want to put more sensitivity in. But right now, we think we're in a pretty good spot.

Ken Usdin
Analyst, Jefferies LLC

Q

And do you have an upper bounds of the sensitivity and how much you let it float off? And thanks for the answers, David.

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

A

What we really want to do is we're not trying to top pick our margin in NII. What we're trying to do is have a repeatable, predictable income statement. What we do when rates get to a point where there's risk of it going down, we do have risk parameters in terms of how much risk we can have on NII with a 100-basis-point move. But for us is really trying to anticipate where the market is going to move, so we can take full advantage there. But we don't want to have an unusual pickup in any given period, whether be a quarter or a year. That's not repeatable. That's not helpful to score our shareholders over time. So, we're trying to get back. We had given you a range of getting up to our margin in the 3.70% range with a normal interest rate environment. We're probably going to be in the higher 3.30s on a core basis this quarter coming up. So, we'll have a little bit of growth there, but it's just making incremental moves on the portfolio as we see the interest rate environment change.

Ken Usdin
Analyst, Jefferies LLC

Q

Thanks again, David.

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

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

A

Good morning, Gerard.

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

A

Good morning, Gerard.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Hi. David, can you elaborate further on slide 8 where you give us the interest rate exposure and you talked about your deposit beta, particularly in the first 100 basis points of being 25% due to the higher betas on your surge deposits. Can you tell us how large on the surge deposits on the [audio gap] (40:40) and can you give us some color on how you define surge deposits?

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

A

Yeah. So, our total surge deposits just mathematically are about $39 billion, okay? And so, when you think of those surge deposits in terms of beta reaction, there's really two things that are happening with those surge deposits. Of the surge deposits, about 65% of those, we think would have actually a lower beta – I'm sorry, a higher beta. That's $25 billion, and we would put that beta at 75%, all right. I would think it's going to be pretty high, pretty reactive. If you look at the other 35%, we think based on that nature of those accounts that those deposits went into, that that beta is going to be similar to our legacy, the beta which is 10%. Then, if you take the rest of our core legacy deposits, we put a 10% beta on that as well. And if you go back and look at the last 100-basis-point rate increase that we had the last cycle, that's what the beta was. So, that's the math that we've really gotten to in our guidance that we're giving you.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

And David, on the surge deposit and the exit non-operating deposits from your corporate customers or the consumers that makes less money leftover from the stimulus?

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

A

Yeah. A big portion of those surge deposits are corporate deposits that came in because that's the best place they could put their money. And that's why we believe that 65% of those deposits, call it, $25 billion at 65% of the $39 billion. It's going to be very reactive because their corporate customers that are likely to put – want to put those to work in a more meaningful place. And we don't need to pay up for that. So, we expect those to probably either move out or to be more expensive.

Gerard Cassidy
Analyst, RBC Capital Markets LLC

Q

Very good. And then, as a follow-up, you highlighted your net charge-off ratio. I think you said, it's the lowest that you've seen. And about this fee [indiscernible] (43:02) pointed to net charge-offs initially, probably staying around the low levels you saw in the fourth quarter, gradually in the second half of the year start to head towards maybe normalization. Is that based on just because the rates were so low that it's hard to maintain that? Or is it formulaic or some underwriting that you have done that says now we're going to start – slowly start to see higher net charge-offs later in the year excluding, of course, the acquisitions that may have influenced the reported numbers?

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

Yeah. It's not an underwriting change. It's a reality that obviously consumers and businesses were propped up by stimulus, consumers in particular. While that stimulus is running out in this quarter in terms of the child care tax credit, we've been unusually low has it – as has the – in the industry. So, I think that our expectation is we would start to normalize because of the run-off of the stimulus, which starts manifesting itself in the second half of the year.

But that being said, we still think charge-offs will be rather lower than history at 25 basis points to 35 basis points for 2022. We have – if the economy continues to perform and consumers do well and manage your money well, maybe our charge-offs at the lower end of that range. So, a bit of it is trying to anticipate when normalization will occur.

Gerard Cassidy
Analyst, RBC Capital Markets LLC
Q

Very good. Thank you for the color.

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

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

Morning, Matt.

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

Good morning. It might be a little bit too early to think about this, but given rate expectations have increased so much, when does that start factoring into how you're underwriting? Because obviously if rates go up to 3% or even more, it does put pressure on borrowers.

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

Well, I think, Matt, one of the things – so we're talking about four 25 basis points moves to get off of virtually zero. If you think of a consumer, a lot of the consumer portfolios are fixed rate portfolios, so they don't end up having much of an interest rate shock in four moves.

On the corporate banking side, again, four moves on them, we've been monitoring our customers. We know which – where they stand. A lot of them hedge. We would expect that as rates starting – start to move, we actually put on – our customers would put on more hedge protection, if you will. So, we – again, we don't see a lot of payment shocks there. I think it's – the risk is running out of stimulus and also is there something unique in a given business or industry that could drive losses higher versus rates at this point.

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

But the only other thing I'd say is on a normal course of business and when underwriting credits, we're always stressing for interest rate sensitivity and – among other things that might occur. So, that would not be a change in our common – current practice.

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

Q

Okay. And then, just separately and apologies if I missed it. Your Capital Markets revenue has been strong all year, and you did increase kind of the run rate for 2022. But we've seen some of your peers have really strong cap markets fees in 4Q. And I think part of it might just be a mix issue, but maybe you could talk to that, if you didn't earlier. And if you did, I'll look at the transcript. Thank you.

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

A

No, no, no. I think it's a good question. If you just look at the bulk of our Capital Markets revenue distributed across both capital raising and advisory services, so whether it's real estate, permanent placement, M&A, loan syndications, or fixed income transactions, we are generating relatively similar amounts of revenue across those platforms. So, we got good diversity. Now, we've added Clearsight Advisors and we've added Sabal Capital. And so, when you consider the contribution that those acquisitions will make in concert with the businesses that – or products capabilities that we've developed, we think the run rate of $90 million to $110 million per quarter is appropriate.

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

Q

Okay. Thank you.

Operator: Your next question is from the line of Stephen Scouten with Piper Sandler.

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

A

Good morning.

Stephen Kendall Scouten
Analyst, Piper Sandler & Co.

Q

Yeah. Good morning. Thanks. So, just one clarifying question, first, I wanted to make sure, David, from your earlier commentary that the loan growth, the 4% to 5% does include the run-off of PPP or is it ex that PPP impact?

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

A

No, it includes that. It's – that was one of the important points that it includes overcoming that and having 4% to 5% growth on the average that you see for the year and it's in our supplement.

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

A

Perfect. That's what I thought I heard. Thank you. That's great. And then, maybe the – one other question I had is, can you talk a little bit about the hand-off kind of from the hedging income to the greater rate sensitivity that obviously now you're pulling forward a bit. I know you have some detail there on slide 20, but I'm just kind of wondering if you can walk through that. Is there the possibility that on a quarter-to-quarter basis we could see some decline, is that $140 million run rate kind of pulls down and the impact of higher rates pulls it back up?

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

Well, I mean, you can always have a little timing issue from a quarter-to-quarter. But we've got a number of things going on in that chart that you can see, in particular our growth, loan growth in our EnerBank transaction that we had. But a good portion of our hedge portfolio is locked in and we're adding the sensitivity of – I forgot who asked the question earlier, but we had a little bit of sensitivity that help us in the second half of the year.

The key thing on the early moves, too, is that we're still very asset sensitive because of our deposit base. And so, when you start seeing the first couple of moves, that bait is pretty close to zero. And so, I think that will aid in the hand-off, but it might not be perfect. But if you're looking at making an investment in us over a period of time, we've got to – we think we're well positioned to grow as the economy continues to grow. We get higher rates and that's where Regions really shines because our deposit base that low core – low-cost core deposit base of ours is better differentiator for us, as you haven't seen – we haven't been able to extract the value out of it because we've been in such a low-rate environment. But now we're starting to see that opportunity if, in fact, we get the rate increases that the forms have baked in.

Stephen Kendall Scouten
Analyst, Piper Sandler & Co.
Q

Okay. That's very helpful. And just the one other point on that chart is the impact of organic growth obviously is increasing in each subsequent year in 2023 and 2024. Is that to convey that you think organic growth can be even better from a loan growth perspective or just that it will be more meaningful given it will be at higher rate?

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

Well, it's a little bit of both. I think we can continue to see absolute balance growth. We've acquired new portfolios, and as I mentioned, so just one example is EnerBank, where we added $3 billion. The production there historically had been about $1.7 billion. We're in a lot of states and we have a distribution that's far better in our bank than what they would have had. And they were a regulated energy company, right? So, we have the ability to take that to a new level. And so, that's just one example. That's why we continue to make investments because we see opportunities to take a portfolio and be able to push that through our network and all the people that we are working for us to continue to grow. You're also getting help by the rate environment. So, that's baked into that 4% to 6% compound annual growth rate as well.

Stephen Kendall Scouten
Analyst, Piper Sandler & Co.
Q

Perfect. That's encouraging. Thanks for the color.

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

Yeah.

Operator: Your next question is from the line of Christopher Spahr with Wells Fargo.

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

Morning.

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Christopher Spahr
Analyst, Wells Fargo Securities LLC

Q

Good morning. So, my question is about 2023 expenses. Last month, you said 2.5% was kind of a core run rate for at least to think about wage increases. Is that kind of a good starting point to think about expenses for next year?

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

A

Actually, Chris, we've had – we've seen some inflation this year. That number is going to be a little bit higher as we think about merit increases, payments we need to make to retain certain folks, in particular people that are in the technology side of the house, recruiting those type things. So, that 2.5% is a little bit higher than that now. That is baked into the guidance we gave you. And so, I guess, bottom line is we have experienced inflation and we expect that to persist into 2022.

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

A

No. Chris' question was around 2023. If I heard you correctly, Chris.

Christopher Spahr
Analyst, Wells Fargo Securities LLC

Q

That's correct.

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

A

And that inflation, that's not transient. That's a going to be in the run rate for 2022. And then, you're going to continue. Now, will you be able to revert back to merit increases that are more consistent in 2023 like we had in the past, and I think that's accurate.

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

A

Yeah. I guess I'm going to turn [audio gap] (53:17).

Christopher Spahr
Analyst, Wells Fargo Securities LLC

Q

So, the difference between deal-related cost that you've seen this year versus what is going to be more about run rate inflation or wage pressure?

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

A

Well, the main thing is the 3% to 4% that we're going to experience, the vast majority of that is related to the acquisitions that we had.

Christopher Spahr
Analyst, Wells Fargo Securities LLC

Q

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Okay. And then, one quick follow-up, please. So, last month, you said I think 2% was a good starting point to put money to work I think given kind of a high level of dry powder, even with the surge deposits. Is that still your thought process or do you think it's going to be a higher level now given with the 10 years already?

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

Yeah, no, we still think – so we think the short end as we told you, we probably have four short-term rate increases going in this year, but we still think the 10-year kind of hangs out and approaches 2% by the end of the year. So, we don't move as much.

We do think there's opportunities. There's a lot of volatility there if we see the ability to put $1.2 billion or more to work in the securities book and were convicted on that, we'd be happy to. We have more cash – idle cash than most everybody because we just have been reluctant to want to take the duration risk because we just don't think we're appropriately compensated for it. That being said, things can change. And if we see closer to that 2% on the 10, that may persuade us to put a little bit more to work.

Now, remember, we're getting paid for all the increases on the short run – short rate for the money at the Fed, so we're getting paid a little bit more there.

Christopher Spahr
Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: Your next question is from the line of Vivek Juneja with JPMorgan.

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

Good morning, Vivek.

Vivek Juneja
Analyst, JPMorgan Securities LLC
Q

Hi, David. Hi, John. So, just a clarification on a couple of the last two questions. So, you said if the 10 year gets closer to 2%, you might put some to work with you. Is anything factored into your NII guidance for reinvestment of some of that liquidity or not?

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

No, we do not. That would be on top of what we're giving you.

Vivek Juneja
Analyst, JPMorgan Securities LLC
Q

Okay. And then, on the expense question that I just asked, so are you assuming the incentive comp increase that you had in 2021? Is that – stays at that level in your 2022 guidance?

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

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No. It's not forecasted to stay at that level. That was...

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Okay.

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

A

The incentive comp was up, I think, across industry and we don't forecast that it would remain at that level at this time.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Okay. And then partly because you're assuming some of those revenues will not continue, like mortgage and capital markets?

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

A

Well, no. We've given you in our revenue growth, but that's all baked into the budget. And so, you don't get compensated at that level over par if you hit your budget. You've got to have a much better year than that, which is what we and most of the industry players did this year. But you reset your expectations, now you're back down at par. You got to start it all over again.

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

A

That makes sense. Yeah, we're increasing targets. So, that will have a – the impact of reducing incentives.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Right. Right. Okay. Makes sense. And the last one for both of you, loan growth, you've talked about very strong pipelines, which implies that you're expecting loan growth to remain good. Are you seeing implies that we are expecting loan growth to remain good? Are you seeing that? How are you seeing January? How are you seeing January? Has that continued to be strong because we obviously saw a bigger pickup later in fourth quarter and in fact continuing in this first – couple of three weeks.

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

A

Yeah. Our pipeline is still good. Customers are optimistic. They are, I think, hopeful that we'll see trends continue. They're prepared to make investments. Investments are still constrained in some measure by some uncertainty and by shortage of labor in a lot of cases. But we do have – there are a lot of customers who are actually looking at investments and want to expand their balance sheets, invest in businesses, and the same is true of consumers who are spending. And so, we do expect just to continue to see loan growth.

Vivek Juneja
Analyst, JPMorgan Securities LLC

Q

Okay. Great. Thank you.

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Operator: Your final question is from the line of Jennifer Demba with 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. Could you just talk about your interest now in more non-bank acquisitions, and where – if that's still the case, where your interest lies, where the strongest interest lies in terms of revenue diversification?

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

A

Yeah. So, we do continue to have an interest in non-bank acquisitions. We like to think continue to add to some of the consumer lending capabilities we have acquired if those opportunities arise, invest in Capital Markets. I think that got a nice return on those investments and been able to leverage those new capabilities to expand relationships. We're interested in opportunities within wealth management. I'm always looking to acquire mortgage servicing rights if those are available and to potentially add to our mortgage business. So, those would be a couple of areas where we would make investment.

Jennifer Demba
Analyst, Truist Securities, Inc.

Q

Perfect. Great. Thanks so much.

Operator: Thank you. I will turn the call back over to John Turner for closing remarks.

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

Okay. Well, thank you. We're also proud of 2021 and all that our associates have accomplished during some very challenging times; staying focused on our customers, on each other; investing in our communities. We think we are carrying a lot of momentum into 2022. Very optimistic about the prospects of an emerging and good strong economy. And so, appreciate your interest and support. Thank you very much.

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

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