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MANAGEMENT DISCUSSION SECTION

Unverified Participant

Good morning everyone. I'm [ph] Gerry Benson (00:03) and up next we have Regions Financial. Regions Financial is a commercial bank based in Birmingham, Alabama with $123 billion in assets. They provide banking services throughout the South, Midwest and Eastern United States. Regions operates three main segments, the Corporate Bank, the Consumer Bank and Wealth Management.

Presenting today for Regions is David Turner, Chief Financial Officer. David joined Regions in 2006 and was named CFO in 2010.

With that, please join me in welcoming David.

David J. Turner, Jr.

Senior Executive Vice President, Chief Financial Officer, Executive Council and Operating Committee, Regions Financial Corp.

Thank you, [ph] Gerry (00:40). I appreciate all the applause. This is going to be fun. No, thank you. No, I'm not saying that I got in trouble for doing that one time. No, seriously, thanks for having us at the BancAnalysts Association conference. I'm here with Deron Smithy, our Treasurer; and Dana Nolan in Investor Relations. And I do want to reference our forward-looking statement disclosures and non-GAAP reconciliations that are in the appendix. So please take a minute to read those.

So let's get started with it; from a strategy standpoint, we really haven't changed much in terms of our strategic initiatives. We've had the same three you've seen since our Investor Day in 2015; growing and diversifying revenue, disciplined expense management and deploying our capital effectively. It's really been important from a growing revenue standpoint that we continue to grow our customer accounts and we've done a pretty good job from that standpoint.

We'll talk a little bit about NII and NIR in detail in a minute. From an expense standpoint, being disciplined with regards to expense management, [ph] what (02:01) we think is really important, in particular as we think about a fairly low growth – been in low rate environment as well. We have been committed to ensure that we generate positive operating leverage and have done so.

As we think about the details of expense management, we did have an announcement at earnings that we would have – that we accelerate our $400 million expense program into 2018. We had had that last $100 million that we said we'd get in 2019, we moved up the bulk of that into 2018.

In doing that, we also identified opportunities where we could go further than that and we announced that on our earnings call. We will have more information for you in December at our next conference to help you understand what that is and what that means to us.

So, for us, optimizing and deploying our capital effectively is really important to us, getting our common equity Tier 1 to the level that we need to have. We've talked about 9.5% based on our current risk profile. Today, we're at 11.3% on that ratio, so we have a ways to go.

We would rather put our capital to work organically, growing the loan portfolio and we can talk about that in just a minute as well. Getting our dividend, robust dividend; today, we pay out about 37% of our earnings and dividends. We use a little bit of capital for strategic investments, mortgage servicing rights and you should expect to see some of that. And then we've been buying back a lot of our stock, which is the last thing we want to do but we'll do when we can't get our capital effectively deployed.

So what does that mean in terms of year-to-date performance? As you think about our year-to-date performance, we've been successful in executing our strategy; 7% increase in year-to-date net income and a 13% increase in year-to-date diluted earnings per share. We continue to stay focused on what we can control and that is growing customer accounts, checking accounts, credit cards, wealth customers, assets under management, consumer loans and the like.

We did and continue to benefit from an asset-sensitive balance sheet and our strong deposit franchise. That is a competitive advantage for Regions and we continue to benefit and will benefit as rates continue to increase.

Our net interest income increased 4% year-to-date and net interest margin increased 18 basis points to 3.31%. Other areas where we're staying focused on are expenses, we – well controlled. They're down 2% year-to-date. And our efficiency ratio improved 130 basis points.

If you look at credit, virtually all of our credit metrics have continued to improve, criticized and classifieds, non-performing loans. So our credit quality is in really good shape. And we've had a robust return to shareholders. Year-to-date, repurchase and dividends have exceeded $1 billion.

So as we think about pre-tax pre-provision income, despite weaker than expected fee income and loan growth, our asset sensitive profile and our disciplined efforts to control our deposit beta and focus on efficiency, continue to improve our PPI where we've, year-over-year, increased $57 million or 12%. We're very proud of the execution by our teams on PPI and doing the things that we need to succeed there.

As we think about net interest income and our NIM, again, our asset sensitive profile has benefited us, but controlling deposit costs, we've had virtually no pressure on the Consumer side – business side, a little bit of pressure on deposit costs and Deron will talk a little bit about that.

But being able to grow net interest income and NIM without having meaningful loan growth has been important to us. We do believe loans start to turn in the fourth quarter and I'll talk about that in a minute. So NII increased $17 million or 2% in the quarter and our NIM increased 4 basis points. We did have credit related recoveries in the quarter, linked quarter about $4 billion of NII and that benefited the margin about 2 basis points. Our NIM continues to outperform our peers. We're about 12 basis points above our peer median.

So as we think about the fourth quarter and excluding the benefit of recoveries because we don't forecast those, we expect the fourth quarter NII to be – and NIM to be growing modestly and that's consistent with what we assume LIBOR moving in consistent with an expected December rate hike. So our full year guidance on NII of 3% to 5% remains unchanged.

So from a non-interest income standpoint, this has been important as we work to diversify our revenue source. We grew last year about 7% in NIR and we were looking to grow this year. I know we've had several revisions during the year. For the quarter, it declined $10 million or 2%. Those declines really coming from mortgage and capital markets, offset by increases in service charges.

It's important to also note that part of our headwind has been in operating lease impairments. We've had about $22 million in impairments year-to-date, $10 million of which hit us in the third quarter. We did have about $1 million worth of hurricane losses and fee waivers that also hit non-interest income.

That being said, we expect the fourth quarter to turn and to grow. We expect that to come from capital markets. There were some transactions we thought were going to hit in the third quarter – that were going to hit in the third and the fourth quarter, they've been pushed to the fourth and first. And we do expect mortgage to rebound some in wealth and cards should also have some increases in the fourth quarter. So the full year guidance being unchanged or relatively stable.

From an expense standpoint, we can control expenses. We've done a pretty good job here. We really have stayed focused and we'll continue to do so because we think we're going to be in a low growth, low rate environment. Although getting better, we still want to make sure we hit the targets that we laid out at Investor Day.

For the third quarter, net interest expense – non-interest expense decreased $23 million or 3%. However, included in that were $12 million worth of hurricane losses that we had. And despite that and the operating lease impairments, the adjusted efficiency ratio improved 150 basis points to 61.7%. And our full year guidance on efficiency ratio of 62% remains unchanged.

From an asset quality standpoint, if you exclude the impact of the hurricanes, you saw we had a $40 million provision for that. That was our best estimate of losses that we had incurred due to the number of storms that we had. But our credit quality continues to improve, non-performers, criticized and classifieds, TDRs all down, a big improvement in commercial loans.

Charge-offs did increase $8 million to 38 basis points, but that was primarily related to two large energy credits that totaled about $28 million. Year-to-date, our charge-offs totaled 41 basis points and that includes all-in with energy. So we're still within the guidance that we gave you, which was charge-offs between 35 basis points and 50 basis points.

Just talk a little bit about loans; from a loans standpoint, new and renewed production was very strong at $16.2 billion. We were up on the total loan production about 9% year-over-year. If you were to look at the commercial production, it was up 15%. So we're feeling very good about that. Current pipelines are at the highest level they've been all year, which gives us confidence that we were going to be able to grow end-to-end loans in the fourth quarter.

We did have Consumer growth of $180 million. Embedded in that – on an average basis, embedded in that were $205 million worth of indirect auto vehicle loans related to a third-party contract that we had not renewed. So without that we would have grown Consumer about $385 million.

This past quarter was unusual. We saw borrowers taking advantage of the capital markets as spreads contracted. Spreads, year-over-year, are down about 9 basis points for us, by the way. We saw that happen not just at Regions but across our peer group. We had several investor real estate loans that really paid off early, reflecting the low capitalization rates. And we did see some M&A – modest M&A activity that further worked against us from a loans standpoint.

As you know, we've been de-risking in certain areas of our company relative to energy and construction real estate and medical office buildings. And we also have been recycling some of our large shared national credit book that have put – that's put pressure on net loan growth. We believe those efforts have been the right thing for us to do as we ensure that we're getting paid for the risk we take and continuing to improve our return on capital that we have put in place.

So from a full year guidance standpoint that remains unchanged, which is excluding the impact of the indirect third-party vehicle runoff. Full year average loans will be down slightly compared to the prior year.

From a deposit standpoint, similar to loans, we had a deliberate strategy to optimize our deposit base and we have a loan-to-deposit ratio of about 81% and we still have a focus on growing the low cost, very valuable deposits, while reducing broker deposits and collateralized deposits.

From a Wealth standpoint, wealth deposits decreased $276 million or 3%. And those are collateralized trust deposits that our customers – we didn't want to pay up for. So those trust officers moved the deposits somewhere else, but they're being paid on the assets under management still from a fee standpoint.

The reason I point that out is to the extent we need to get deposits back, we can do that pretty quickly. We just have to pay up a little bit for them, which we don't need to have today. We have averaged Other segment deposits decreased $220 million or 7%, which was really related to retail broker sweep deposits that have a really high beta funds that we don't think provide much liquidity value to us at all.

So with that, full-year guidance remains unchanged. So total average deposits should be relatively stable with the prior year.

I want to transition right now and let Deron talk a little bit about our deposit advantage in our deposit base and then we'll open it up for questions.

Deron Smithy

Treasurer, Regions Bank

So good morning and thanks, David. So you heard David allude to the deposit advantage that we think we have and really it's an overall funding advantage for us. And what I wanted to do is spend a couple of minutes talking about the characteristics of the portfolio that we think drive that advantage.

So, yeah, we're on the right slide. So first and foremost, I would say the big driver is two-thirds of our book is Consumer – driven by the Consumer and Wealth channels. And within that it's a fairly granular book, so lots of smaller dollar deposits. And really that's a function of our strategy over time to grow households, grow client relationships rather than trying to attract large lumpy deposit dollars through high rate promotional strategies. So over time, what we've developed is a really sticky core deposit or a sticky consumer deposit base.

But the same is true on the commercial side as well. As we follow our Regions 360 strategy focusing on growing client relationships and getting the stickier services, so getting operating accounts, getting treasury management services, we believe all of those services lead to a more loyal client and a stickier relationship. And it's one of the reasons why 38% of our deposits are non-interest bearing in nature which ranks in the top quartile of our peer group. So even more importantly though is that it's a very loyal book. So approximately 43% of our deposit base represents customers who bank with Regions for over 10 years, again, really just reflecting our longer term strategy of attracting relationships rather than just growing deposits.

So next, I want to talk about how that contributes to our overall funding advantage. So the chart on the right shows two things and I'll focus first on the blue lighter shaded bars which represents total deposits as a percentage of total liabilities, where 91% of our balance sheet is funded from deposits which is second on this chart, very close to number one, but that's a real advantage for us.

Second, you can see the percentage of non-interest bearing as a percentage of total deposits. Again, we're third in the peer group here. But you put those two together that's a pretty powerful base for funding the balance sheet. The chart on the left has two dimensions on it, really speaks to deposit betas both as for the whole tightening cycle, but also the most recent quarter.

So the Y-axis represents the cumulative betas for ourselves and the peer group since the Fed began tightening late in 2015. And you can see that we are at about 11% total cumulative beta. And really within that, it's a bifurcated story. On the commercial side, we've got indexed accounts and accounts that move a little more immediately and we've had betas roughly in the low-30s on the commercial side. But on the Consumer side, again, which is two-thirds of our book, we've seen less than 1% movement in rates thus far, so very low movement on the Consumer side.

The X-axis really just speaks to what our peers have experienced over the last quarter and what you can see is our own experience where deposit rates went up 3 basis points but only to 17 basis points, which is still third lowest in our peer group. But as you can see to the – on the right-hand side of this chart, many of our peers are starting to experience rate moves to a greater degree. And so what that means is, frankly, the deposit betas have been low for the industry thus far in this tightening cycle and I think that – that's a byproduct of the Fed going slow. And there have been more intermittent rate increases and so we've all been able to keep deposit rates relatively low.

But Regions' advantage, I think, is now just starting to emerge as many of our peers are feeling the pressure to start increasing deposit rates, but we think we can continue to outperform the peer group there and that'll be a source of both profitability growth and continued growth in net interest income in the future.

So let's talk about our asset sensitivity and our – the way we're positioned for future rate increases. So as the Fed continues to normalize policy, we think we're well positioned for continued growth in NII. We have a naturally asset sensitive balance sheet. At its natural level, roughly two-thirds of our loan portfolio was floating.

We do a fair amount of hedging to create more of a balanced asset sensitivity position. The net of all the hedging gives us about a 48% floating rate loan book. But again that's being funded by a relatively rate-insensitive deposit base. And so, again, as short rates rise, we think we're well positioned to continue seeing advancement in the margin.

One more point I want to make here, though, is regarding medium- and long-term sensitivity. In the past, we've talked about our exposure to long-term rates as being a potential headwind if rates remain low and that was really driven by premium amortization in the mortgage-backed securities portfolio. At current levels, many of the underlying loans in those securities are economically locked out from refinancing. And so the premium amortization impact is much smaller for us today and has much less variability.

So as you think about the impact of medium- and longer-term rates, it really becomes a tailwind for us as our balance sheet, just the natural reinvestment in the securities portfolio, as well as new business creation, fixed-rate lending will be marginally accretive from here. Even if rates don't move materially higher, the quarterly re-pricing of the balance sheet will be a tailwind for the margin. Obviously, as rates move higher that benefit increases.

So, get move on to sensitivity, so as you think about our sensitivity profile, the assumptions we make here are big driver, obviously, those around the deposit base. Two, I want to point out. We talked about betas. This gives you a snapshot at the bottom of the chart, which I think is a good rule of thumb for us is what's the value of five beta points. And so we show here that the value, if betas were reduced in our standard shock, where we assume 40% beginning beta ramping up to 60% over time, if betas were reduced by 5 – by five beta points that'd be worth roughly $26 million to us annually and ending up $100 million. So the value of a quarter point increase for us is $6 million to $7 million for each five beta points.

So as we give guidance for the margin next month, we'll give you a range for net interest income growth, but this will be helpful for you to navigate to both ends of the range, understand what are the drivers that get us to both ends of the range.

The other key point I want to make here is we do think our non-interest bearing as a percentage of total deposits is a strength of ours. But in our standard rate shocks, we do assume migration out of non-interest bearing into our more costly time deposit portfolio of about $3 billion, which represents about 8% change. So effectively, we would take ourselves from a position of strength down to the peer median as a percentage of total deposits from a non-interest bearing standpoint. And you can see what the impact that has on sensitivity. We further stressed that and we'll give you the range of full sensitivities in the chart on the bottom.

So, before we take your questions, I did want to close with a couple of slides on capital. We have very robust capital levels. At the quarter-end, we were at 11.3% down from 11.5% in the previous quarter, reflecting the beginning of our share repurchase program.

But we also have – I want to talk about the priorities for use of our capital. As David mentioned, first and foremost, we want to use our capital to grow our business, both organically and strategically where that makes sense. And growth is our top priority, but it's got to be the right kind of growth. It's got to be growth that meets our overall return objectives, is consistent with our strategic plan and is well contained within our risk limits and – but it is our number one priority.

Next, we want to maintain what we would describe as an appropriate, sustainable dividend, which today, we're in roughly 36%, 37% of earnings range. We've espoused a 30% to 40% range. Currently, we think that migrates up to 35% to 45% over time. And then once we've exhausted these opportunities, we will engage in share repurchase activity to get our capital levels down to our target which we've communicated is 9.5%. I think the key here is that we believe we have enough capital to support the growth in our business both organically and strategically and still provide a robust return of capital to shareholders.

The last page that I'll close with just shows our activities regarding our recent capital plan. As you know, we had a robust increase to the dividend, 29% through the most recent CCAR cycle. We've announced a $1.47 billion share repurchase program of which we've completed the first $500 million of that repurchase in the third quarter.

And again, we think we have sufficient capital to both continue to have a robust return of capital to shareholders in the near term as well as satisfy all of our growth requirements.

So with that, I think we'll take your questions.

QUESTION AND ANSWER SECTION

Q

Go ahead [ph] Keith (26:02).

Q

[Question Inaudible] (26:04-26:23).

Deron Smithy
Treasurer, Regions Bank

A

Yeah. So, obviously, we are a bank that screens more heavily for branch presence. And I would tell you today, still 80% of our total sales come through the branch network. However, if you look at activity in the branch versus online and mobile, it's steadily progressing toward online and mobile for us. So clearly, it's something where – we're focused on and we believe it's a minimum that we have to have a robust online and mobile platform.

There – I don't think for us it's one specific thing that is – that we're doing. We're trying to clearly be aware of what's going on with our competitors, what others are doing that are – that we find value in. I think this is a space where there are a lot of the larger banks who are putting a lot of money to work and focusing heavily on building out their digital platform. I think it's a place where we're not likely to be a leader but we're going to be a close follower, but it's something certainly that we're focusing on and we're thinking not just for today but for the future.

Dave, anything you want to add to that?

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer, Executive Council and Operating Committee, Regions Financial Corp.

A

Yeah. I would say, clearly, we don't have the ability to match the larger banks in terms of the spend they can have in the digital space. We have made investments in online and mobile. We see the traffic increasing dramatically through those channels. We see the transactions at the teller line and the branch coming down, as you would expect.

We don't believe there's a sustainable competitive advantage by those that spend a lot more money. They get to fail and learn and we get to learn from their failures. So I think that, clearly, customers want things to be easy. We're all customers too, we want things easy and it's incumbent upon us to continue to make banking easier for them. And that's a big part of our cost initiative that we're talking about and I'll give you further details on in the – in December.

But I think digital has its place not only from a customer service and deposit acquisition standpoint but digitization in the back office too, in terms of how we just do what we do every day. So we are committing more capital there, but nowhere close to the – to what the big guys have.

Q

[ph] Ken (29:00).

Q

[Question Inaudible] (29:02-29:29).

Deron Smithy
Treasurer, Regions Bank

A

Yeah. So I'll start. So we recognize that as we've been in this longer low rates cycle, there's been consolidation of funds and accounts that you can't expect they're going to remain there as rates rise. Things like on the commercial side, earnings credit rates increasing are going to allow our customers to meet their fee needs by keeping smaller balances. So our expectation is and it's what we build into our core sensitivity analysis is that we'll see a migration out of NIB into other categories. And so part of the strategy is to monitor what – how customers are requesting and/or telling us what their – what they want. And so we have strategies that are designed to as – again when on a commercial side, if customers have excess balance of strategies that are designed to find the better alternatives for them.

On the Consumer side, really focusing on growing checking accounts and the smaller savings accounts. Really, there's not a high concentration of large deposit balances in those. And so, I don't feel like there's going to be mass migration out of those but there are a lot of our customers today that are sitting in money market accounts waiting for an opportunity for a rate they like from a time deposit standpoint.

And so we're always exploring in running tests in our markets as to promotional offers, to determine what customer sensitivity is. And so it's a matter of being close to the customer, understanding customer needs and always making sure that we have an appropriately priced product that is sort of aligned to their changing needs as rates rise. But I do expect that we'll see $2 billion to $3 billion of migration out of NIB into higher rate accounts.

Q

[Question Inaudible] (31:47-32:31).

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer, Executive Council and Operating Committee, Regions Financial Corp.

A

So I'll start with the cost piece of that and then turn it over to Deron. So we do have to make continued investments and we have to make continued investments in people, getting the right people to help us continue to build out areas that we want. We've talk about capital markets being an example of that, wealth advisors is another example of that.

At the same time, we're at 62% – are going to be at 62% efficiency ratio this year going to less than 60% next year. We think we have to become even more efficient in that, we think the mid-50s is a better spot to be. And the only way to really get there is to continue to look at processes and make investments leveraging technology. So that's going to cost us some. That will be an investment we have to pay for, but we'd like to reset our expense base.

What we've done thus far is we've controlled – we've done a good job of controlling our expenses, but they haven't gone down and they just haven't gone up at the rate everybody else has gone up. So we're looking to see how much we can take out. That's the additional news we'll give you in December. But it will always come with investments in technology; cyber security clearly is – perhaps, the largest risk today that we face. That BSA/AML are probably one and two. And we're investing in technology in both of those areas to become more effective and efficient at what we do.

So we've made the investments in technology from an online and mobile. We'll continue to do some of that, [ph] Ryan (34:08), but I think that we need to take other areas and really be able to pay for those and then some is what we're trying to do.

Deron Smithy
Treasurer, Regions Bank

A

Yeah. And, [ph] Ryan (34:18), I think going back to Investor Day, the rate outlook was much rosier than what has played out. And so, to some extent, we are ahead of schedule here. Clearly, I think that is being driven by the lower deposit betas thus far. We won't stay at 11%. But if rates continue to normalize and I think if we get up into that 2.50% to 3% on the Fed funds range, deposit betas will begin to pick up in the next one or two tightenings.

I think longer term, though, we will outperform perhaps what was baked into our model. So I think the combination of – we're getting there slower. But ultimately, if we do get there, I think there's an opportunity to outperform that level that we gave out. But there're a lot of factors, business mix and other things that contribute to that, but I still think that's a reasonable range for us, if not a little better.

Q

[ph] Geoff (35:25).

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer, Executive Council and Operating Committee, Regions Financial Corp.

A

Hey, [ph] Gerard (35:25).

Q

David, you have been very clear about your targeted Tier 1 capital ratios of 9.5%, you're currently obviously almost 200 basis points over that at a great, robust [ph] cash (35:38) in the last CCAR, what prevents you from doing a step-down, maybe in next year's CCAR and I'm not asking what you're going to do next year, but philosophically, why can't you just bring it down from 9.5% to a CCAR [indiscernible] (35:53-35:59).

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer, Executive Council and Operating Committee, Regions Financial Corp.

A

So we kind of led the CCAR team this year, if you will, the peer group in terms of buying our stock back. We think it's important to be very thoughtful about the amount of capital that we need to have and how we're going to get there. And just because the qualitative aspects of CCAR are not there relative to how they used to be, we're still a regulated environment. We still have others that are watching what we do and they want us to be thoughtful just like you do.

We think having a robust – you should expect a robust CCAR just based on the math, the – your 200 basis points getting down. It's not conceivable that you get this through loan growth only given the 2.5% GDP – real GDP and call it 4%-ish nominal.

So, I think that we still think there's a little play in terms of how you do this that matters and I don't think it's just a finance game. I don't think you can just go and ask for 300% of your earnings. To me – to us, it just doesn't send the right message that you're being as thoughtful. So, we'd love to get there yesterday, but we are where we are. We have a plan and we believe for an investor, having an investor – a long-term investor understand where we're going and believing in that story is good enough.

Deron Smithy
Treasurer, Regions Bank

A

And, [ph] Gerard (37:40), I would just add that the step we took this year in increasing the payout was a big step toward getting to that target. And I think it will be – we'll get meaningfully there through this next CCAR cycle. So, it might not be all at once, as you say, but through the next CCAR cycle, it'll be the second of two major steps to get there over a couple of years. So I think the glide path we're on is going to get us down to that target in a reasonable amount of time.

Q

All right. Last question, [ph] Geoff (38:13).

Q

[Question Inaudible] (38:15-38:48).

Deron Smithy
Treasurer, Regions Bank

A

Sure, it is. It's an average of 30, but your intuition is right. There are some accounts that are much lower than that. And then we have some indexed accounts that are moving in lockstep when short-term rates move. And so it's public funds and other indexed accounts are going to move more rapidly. But there's still money market and other accounts that are not moving at quite the same pace.

Unverified Participant

Okay. Thank you very much, Regions.

David J. Turner, Jr.
Senior Executive Vice President, Chief Financial Officer, Executive Council and Operating Committee, Regions Financial Corp.

Okay. Thank you.

Deron Smithy
Treasurer, Regions Bank

Thanks.