Current and Future Banking Trends for Municipalities

Jason Sweatt and Jessica Payne

August 2015

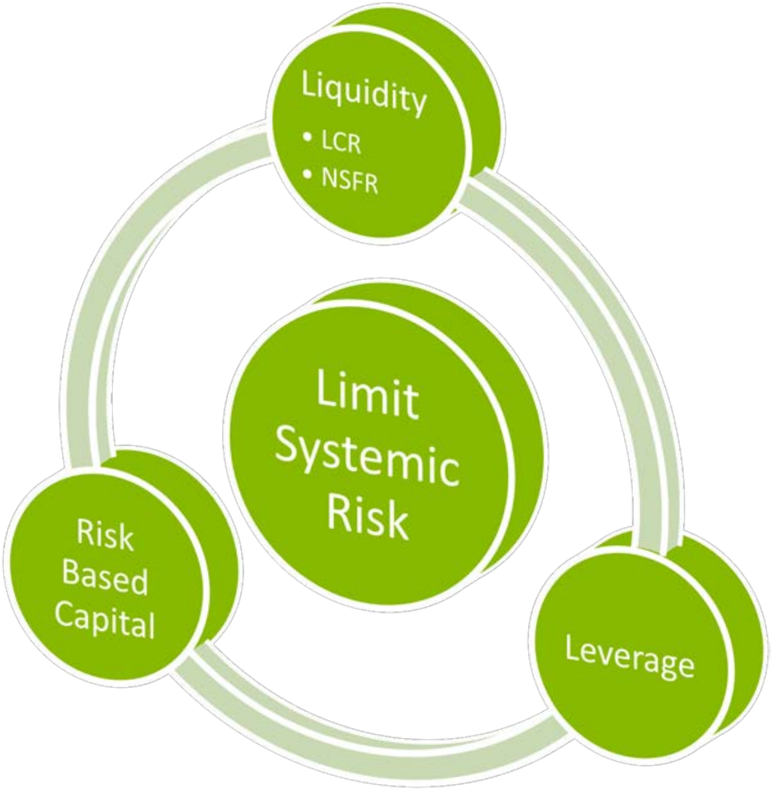
Summary of Trends

- Changing liquidity landscape
- Growth of bank direct placement market
- Evolution of payments
- Banks search for additional sources of Non Interest Revenue
- Increased fraud

2008 – 2009 Financial Crisis = New Rules

- In response to the financial crisis the Basel Committee on Banking Supervision agreed upon a holistic set of reform measures known as Basel III.

- Basel III reform measures aim to:
  - Improve the banking sector's ability to absorb shocks arising from financial and economic stress
  - Improve risk management and governance
  - Strengthen banks' transparency and disclosures



Basel III in the U.S.

U.S. regulators are in the process of fully adopting the Basel III regulation with modifications specific to the U.S. market

Liquidity Coverage Ratio (LCR)	Net Stable Funding Ratio (NSFR)
The Liquidity Coverage Ratio (LCR) will require banks to have sufficient high quality liquid assets to withstand a 30-day stressed funding scenario	The Net Stable Funding Ratio (NSFR) is a longer-term structural ratio designed to address liquidity mismatches. It covers the entire balance sheet and provides incentives for banks to use stable sources of funding
Phased Implementation - 2015	Delayed Implementation - 2018

- September 3, 2014
  - U.S. regulators release the final Basel III Liquidity Coverage Ratio regulation
  - U.S. version is more stringent than the Basel III guidance
    - Timeline has been accelerated for U.S. Financial institutions to comply
    - Definition of operational deposits

Liquidity Coverage Ratio - Bank Treatment

All banks are not treated equal under the U.S. Basel III LCR

Three Bank Tiers

Advanced Approach

- Banks >$250B in assets
- Accelerated timeline to comply
- First compliance date January 1, 2015

Modified Approach

- Banks <$250B and >$50B in assets
- Delayed timeline to comply
- First compliance date January 1, 2016

Not Currently in Scope

- Banks <$50B in assets
- Does not have to comply with LCR

Liquidity Coverage Ratio - Timeline

The staggered implementation of LCR poses a challenge for both corporates and banks when evaluating long term relationships and product offerings.

LCR Implementation Timeline	January 1, 2015	January 1, 2016	January 1, 2017
Advanced Approach	80%	90%	100%
Modified Approach*	0%	90%	100%

Regions Bank is required to adhere to the "Modified LCR" requirement which is slightly less stringent than "Advanced LCR" while remaining highly consistent.

Basel III LCR Calculation

The Liquidity Coverage Ratio (LCR), measures a bank's High Quality Liquid Assets vs. cash outflows in a stressed scenario. The LCR stipulates that banks must have a minimum 1:1 ratio of HQLA to cash outflows.

- Treasuries, cash held at Fed, GSE securities, certain investment grade debt securities
- Three HQLA levels, subject to different haircuts and caps

$$\textbf{Liquidity Coverage Ratio} = \frac{\textbf{High Quality Liquid Assets (HQLA)}}{\textbf{30 Day Net Cash Outflows}} = \textbf{100\%}$$

- Deposit and loan outflows minus cumulative net inflows (capped)

The LCR calculation effectively changes the value of clients' loans and deposits based on regulatory guidance

Unfunded Commitments

The differentiation between "CREDIT" and "LIQUIDITY" facilities will be critical in minimizing the outflow calculation

- Credit pricing will change to reflect the changing value of loan types
- Banks will look to minimize the amount of unfunded loan commitments outstanding

Credit and Liquidity Facility Unfunded Outflow Rates	Modified Approach	Advanced Approach
Undrawn credit and liquidity facilities to retail and small business customers	3.5%	5%
Undrawn credit facility to wholesale customers	7%	10%
Undrawn liquidity facility to wholesale customers	21%	30%
Undrawn credit facility to financial entities	28%	40%
Undrawn liquidity facility to financial entities	70%	100%

Changing Market Dynamics

Relationships

- Banks will look to broaden client relationships by increasing services
- Collateralized deposits add marginal value
- Hard dollar NIR will be very valuable

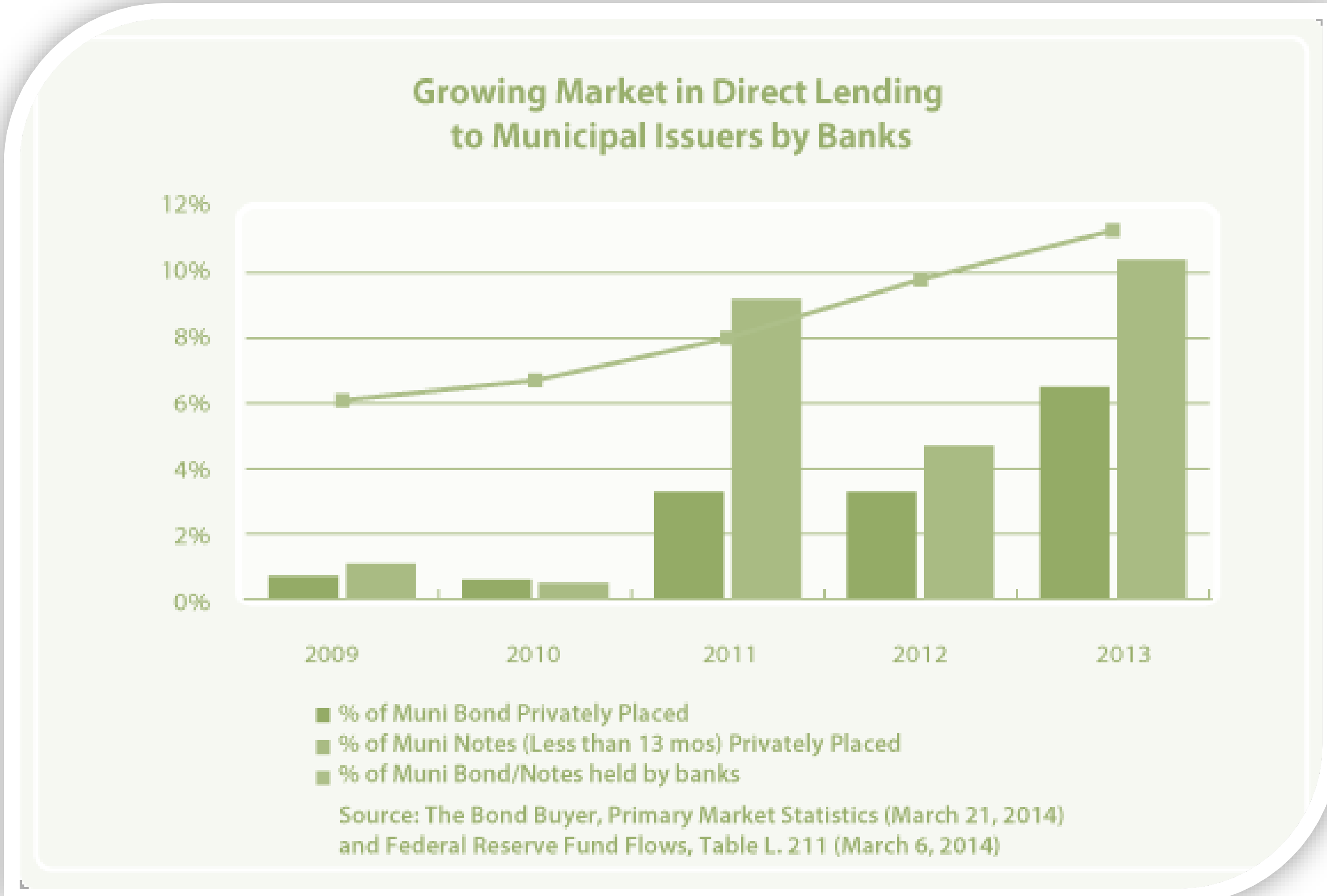
Product Innovation

- New products are being developed to ensure optimization of liquidity both from bank and client standpoint – on and off balance sheet innovation
- Off balance sheet products will become increasingly popular for unattractive deposits

Deposit Impacts

- Large short term deposits will be difficult to place on balance sheet
- Some large banks are currently modifying the balance sheet make-up
- Large dollars are looking for a new home, some may be accretive relationships

Increased Bank Direct Lending



Increased Bank Direct Lending

- Increased demand from banks has led to very competitive market pricing
- New money issuances and advance and current refundings have all been popular
- Muni Advisor Rules have helped provide additional resources to municipalities to help assess options for every transaction
- Common maturities range from 10-15 years, with amortizations often stretching to 20 years
- Other benefits include flexibility in structuring, low up-front costs, some prepayment optionality, ability to negotiate terms

Evolution of Payments

Check

ACH

Wire

Purchasing Card

Integrated Payables

Mobile

Bitcoin?

Mobile Channel Delivery

REGIONS

- Banks will focus on customer experience as a differentiator, especially in the online and mobile channels.
- Most Top 50 banks will roll out corporate mobile payments by year-end 2015 and will offer the capabilities corporate treasurers most need-especially the ability to approve payments.
- Multibank connectivity is key for clients that maintain multiple bank relationships and banks will accept standard interfaces to connect with their clients.
- Banks fight non-bank competitors in the small business space.

Faster Payments

NACHA will introduce Same-Day ACH in 2016. Banks must be prepared to receive and process items in the faster timeframes.

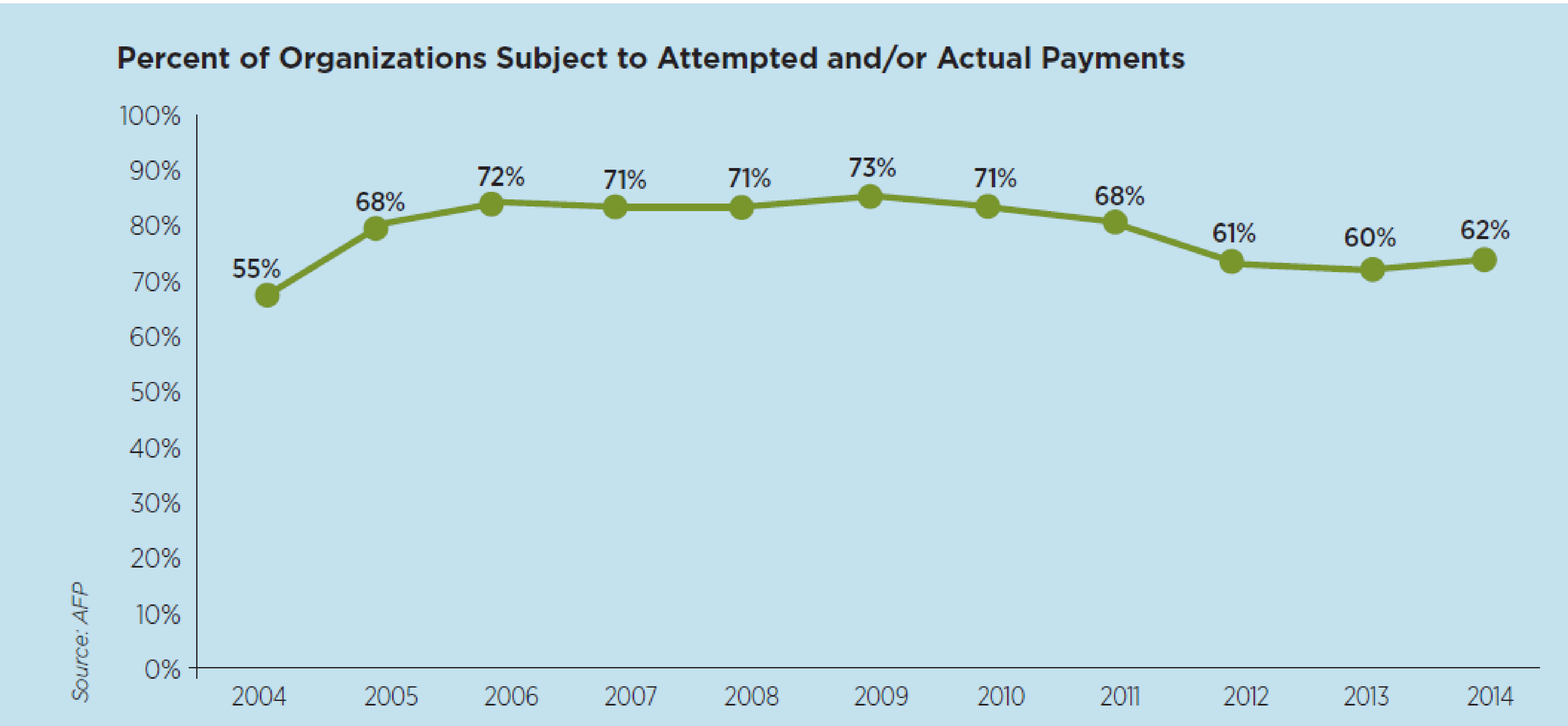
Banks will continue to assess the viability and application of non-traditional payment channels like ApplePay & other mobile wallet applications.

Additional Non Interest Revenue for Banks

Banks diversifying income streams with new sources of Non Interest Revenue, including:

- Merchant Services
- Credit Cards
- Insurance Groups
- Corporate Trust divisions
- Institutional Trust/Investment Services

Risk and Fraud Mitigation



1. *2013 AFP Electronic Payments Survey*

Risk and Fraud Mitigation

As fraud grows, banks will continue to implement processes & systems designed to deter & prevent fraudulent activity.

- Positive Pay, ACH Alert, filters, blocks, and more to come.

Client education will be at the forefront of communications campaigns.

- Fraud seminars and ongoing dialogue around best practices.

Reference

FDIC & Financial Reform
http://www.fdic.gov/regulations/reform/.html

BASEL III
http://www.federalreserve.gov/bankinforeg/basel/default.htm

Money Market Mutual Fund Reform
http://www.ici.org/faqs/faqs_money_funds

Regions can help you work with a broad array of resources to make sure you meet your liquidity needs, including but not limited to investment and trust services and securities and insurance products. Some of these resources are provided through Regions Bank Wealth Management Group. Securities and Insurance products are not insured by the FDIC or any other government agency, are not deposits or guarantees of Regions Bank or its affiliates and may lose value.

Contact Information

Jason Sweatt, CTP

Liquidity and Deposits Manager

Senior Vice President

205.264.7419

Jason.Sweatt@Regions.com

Jessica Payne, CTP

Government & Institutional Banking

Relationship Manager

205.326.5836

Jessica.Payne@Regions.com