FIFTH THIRD BANCORP
Form 10-Q
May 04, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2018

Commission File Number 001-33653

(Exact name of Registrant as specified in its charter)

Ohio	**31-0854434**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

Fifth Third Center

Cincinnati, Ohio 45263

(Address of principal executive offices)

Registrant s telephone number, including area code: (800) 972-3030

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		Emerging growth company

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

There were 685,495,676 shares of the Registrant s common stock, without par value, outstanding as of April 30, 2018.

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FORWARD-LOOKING STATEMENTS

This report contains statements that we believe are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Rule 175 promulgated thereunder, and Section 21E of the Securities Exchange Act of 1934, as amended, and Rule 3b-6 promulgated thereunder. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. They usually can be identified by the use of forward-looking language such as will likely result, may, are expected to, is anticipated, potential, e forecast, projected, intends to, or may include other similar words or phrases such as believes, plans, trend, continue, remain, or similar expressions, or future or conditional verbs such as will, would, should, could, or similar verbs. You should not place undue reliance on these statements, as they are subject to risks and uncertainties, including but not limited to the risk factors set forth in the Risk Factors section in Item 1A in our most recent Annual Report on Form 10-K. When considering these forward-looking statements, you should keep in mind these risks and uncertainties, as well as any cautionary statements we may make. Moreover, you should treat these statements as speaking only as of the date they are made and based only on information then actually known to us. There are a number of important factors that could cause future results to differ materially from historical performance and these forward-looking statements. Factors that might cause such a difference include, but are not limited to: (1) deteriorating credit quality; (2) loan concentration by location or industry of borrowers or collateral; (3) problems encountered by other financial institutions; (4) inadequate sources of funding or liquidity; (5) unfavorable actions of rating agencies; (6) inability to maintain or grow deposits; (7) limitations on the ability to receive dividends from subsidiaries; (8) cyber-security risks; (9) Fifth Third s ability to secure confidential information and deliver products and services through the use of computer systems and telecommunications networks; (10) failures by third-party service providers; (11) inability to manage strategic initiatives and/or organizational changes; (12) inability to implement technology system enhancements; (13) failure of internal controls and other risk management systems; (14) losses related to fraud, theft or violence; (15) inability to attract and retain skilled personnel; (16) adverse impacts of government regulation; (17) governmental or regulatory changes or other actions; (18) failures to meet applicable capital requirements; (19) regulatory objections to Fifth Third s capital plan; (20) regulation of Fifth Third s derivatives activities; (21) regulatory objections to Fifth Third s resolution plan; (22) deposit insurance premiums; (23) assessments for the orderly liquidation fund; (24) changes in LIBOR; (25) weakness in the national or local economies; (26) global political and economic uncertainty or negative actions; (27) changes in interest rates; (28) changes and trends in capital markets; (29) fluctuation of Fifth Third s stock price; (30) volatility in mortgage banking revenue; (31) litigation, investigations, and enforcement proceedings by governmental authorities; (32) breaches of contractual covenants, representations and warranties; (33) competition and changes in the financial services industry; (34) changing retail distribution strategies, customer preferences and behavior; (35) difficulties in identifying, acquiring or integrating suitable strategic partnerships, investments or acquisitions; (36) potential dilution from future acquisitions; (37) loss of income and/or difficulties encountered in the sale and separation of businesses, investments or other assets; (38) results of Vantiv Holding, LLC, a subsidiary of Worldpay, Inc. or other investments or acquired entities; (39) difficulties from or changes in Fifth Third s investment in, relationship with, and nature of the operations of Vantiv Holding, LLC, a subsidiary of Worldpay, Inc.; (40) changes in accounting standards or interpretation or declines in the value of Fifth Third s goodwill or other intangible assets; (41) inaccuracies or other failures from the use of models; (42) effects of critical accounting policies and judgments or the use of inaccurate estimates; (43) weather related events or other natural disasters; and (44) the impact of reputational risk created by these or other developments on such matters as business generation and retention, funding and liquidity.

Glossary of Abbreviations and Acronyms

Fifth Third Bancorp provides the following list of abbreviations and acronyms as a tool for the reader that are used in Management s Discussion and Analysis of Financial Condition and Results of Operations, the Condensed Consolidated Financial Statements and the Notes to Condensed Consolidated Financial Statements.

ALCO: Asset Liability Management Committee

ALLL: Allowance for Loan and Lease Losses

AOCI: Accumulated Other Comprehensive Income (Loss)

APR: Annual Percentage Rate

ARM: Adjustable Rate Mortgage

ASF: Available Stable Funding

ASU: Accounting Standards Update

ATM: Automated Teller Machine

BCBS: Basel Committee on Banking Supervision

BHC: Bank Holding Company

BOLI: Bank Owned Life Insurance

BPO: Broker Price Opinion

bps: Basis Points

CCAR: Comprehensive Capital Analysis and Review

CDC: Fifth Third Community Development Corporation

CET1: Common Equity Tier 1

CFPB: Consumer Financial Protection Bureau

C&I: Commercial and Industrial

DCF: Discounted Cash Flow

GNMA: Government National Mortgage Association

GSE: United States Government Sponsored Enterprise

HQLA: High Quality Liquid Assets

IPO: Initial Public Offering

IRC: Internal Revenue Code

IRLC: Interest Rate Lock Commitment

ISDA: International Swaps and Derivatives Association, Inc.

LCR: Liquidity Coverage Ratio

LIBOR: London Interbank Offered Rate

LLC: Limited Liability Company

LTV: Loan-to-Value

MD&A: Management s Discussion and Analysis of Financial Condition and Results of Operations

MSR: Mortgage Servicing Right

N/A: Not Applicable

NII: Net Interest Income

NM: Not Meaningful

NSFR: Net Stable Funding Ratio

OAS: Option-Adjusted Spread

DFA: Dodd-Frank Wall Street Reform & Consumer Protection Act

DFAST: Dodd-Frank Act Stress Test

DTCC: Depository Trust & Clearing Corporation

ERM: Enterprise Risk Management

ERMC: Enterprise Risk Management Committee

EVE: Economic Value of Equity

FASB: Financial Accounting Standards Board

FDIC: Federal Deposit Insurance Corporation

FHA: Federal Housing Administration

FHLB: Federal Home Loan Bank

FHLMC: Federal Home Loan Mortgage Corporation

FICO: Fair Isaac Corporation (credit rating)

FINRA: Financial Industry Regulatory Authority

FNMA: Federal National Mortgage Association

FOMC: Federal Open Market Committee

FRB: Federal Reserve Bank

FTE: Fully Taxable Equivalent

FTP: Funds Transfer Pricing

FTS: Fifth Third Securities

GDP: Gross Domestic Product

OCI: Other Comprehensive Income (Loss)

OREO: Other Real Estate Owned

OTTI: Other-Than-Temporary Impairment

PCA: Prompt Corrective Action

RCC: Risk Compliance Committee

RSF: Required Stable Funding

SAR: Stock Appreciation Right

SBA: Small Business Administration

SCB: Stress Capital Buffer

SEC: United States Securities and Exchange Commission

SLB: Stress Leverage Buffer

TBA: To Be Announced

TCJA: Tax Cuts and Jobs Act

TDR: Troubled Debt Restructuring

U.S.: United States of America

U.S. GAAP: United States Generally Accepted Accounting Principles

VA: United States Department of Veteran Affairs

VIE: Variable Interest Entity

VRDN: Variable Rate Demand Note

Management s Discussion and Analysis of Financial Condition and Results of Operations (Item 2)

The following is Management s Discussion and Analysis of Financial Condition and Results of Operations of certain significant factors that have affected Fifth Third Bancorp s (the Bancorp or Fifth Third) financial condition and results of operations during the periods included in the Condensed Consolidated Financial Statements, which are a part of this filing. Reference to the Bancorp incorporates the parent holding company and all consolidated subsidiaries. The Bancorp s banking subsidiary is referred to as the Bank.

TABLE 1: Selected Financial Data

		For the three months ended March 31,			%
($ in millions, except for per share data)		**2018**		2017	Change
Income Statement Data					
Net interest income (U.S. GAAP)	$	**996**		933	7
Net interest income (FTE)[(a)(b)]		**999**		939	6
Noninterest income		**909**		523	74
Total revenue[(a)]		**1,908**		1,462	31
Provision for loan and lease losses		**23**		74	(69)
Noninterest expense		**1,046**		986	6
Net income attributable to Bancorp		**704**		305	131
Net income available to common shareholders		**689**		290	138
Common Share Data					
Earnings per share - basic	$	**0.99**		0.38	161
Earnings per share - diluted		**0.97**		0.38	155
Cash dividends declared per common share		**0.16**		0.14	14
Book value per share		**21.68**		20.13	8
Market value per share		**31.75**		25.40	25
Financial Ratios					
Return on average assets		**2.02**	%	0.88	130
Return on average common equity		**18.6**		7.8	138
Return on average tangible common equity[(b)]		**22.4**		9.3	141
Dividend payout ratio		**16.2**		36.8	(56)
Average total Bancorp shareholders equity as a percent of average assets		**11.52**		11.72	(2)
Tangible common equity as a percent of tangible assets[(b)(h)]		**9.14**		9.15	-
Net interest margin[(a)(b)]		**3.18**		3.02	5
Net interest rate spread [(a)(b)]		**2.88**		2.78	4
Efficiency[(a)(b)]		**54.8**		67.4	(19)
Credit Quality					
Net losses charged-off	$	**81**		89	(9)
Net losses charged-off as a percent of average portfolio loans and leases		**0.36**	%	0.40	(10)
ALLL as a percent of portfolio loans and leases		**1.24**		1.35	(8)
Allowance for credit losses as a percent of portfolio loans and leases[(c)]		**1.40**		1.52	(8)
Nonperforming portfolio assets as a percent of portfolio loans and leases and OREO		**0.55**		0.79	(30)
Average Balances					

Loans and leases, including held for sale	$ **92,869**	92,791	-
Total securities and other short-term investments	**34,677**	33,177	5
Total assets	**141,565**	140,140	1
Transaction deposits*(d)*	**97,018**	97,018	-
Core deposits*(e)*	**100,874**	100,845	-
Wholesale funding*(f)*	**20,558**	19,129	7
Bancorp shareholders equity	**16,313**	16,429	(1)
Regulatory Capital and Liquidity Ratios			
CET1 capital*(g)*	**10.82** %	10.76	1
Tier I risk-based capital*(g)*	**11.95**	11.90	-
Total risk-based capital*(g)*	**15.25**	15.45	(1)
Tier I leverage	**10.11**	10.15	-
Modified LCR	**113**	119	(5)

*(a) Amounts presented on an FTE basis. The FTE adjustment for the three months ended **March 31, 2018** and 2017 was **$3** and $6, respectively.*

(b) These are non-GAAP measures. For further information, refer to the Non-GAAP Financial Measures section of MD&A.

(c) The allowance for credit losses is the sum of the ALLL and the reserve for unfunded commitments.

(d) Includes demand deposits, interest checking deposits, savings deposits, money market deposits and foreign office deposits.

(e) Includes transaction deposits and other time deposits.

(f) Includes certificates $100,000 and over, other deposits, federal funds purchased, other short-term borrowings and long-term debt.

(g) Under the U.S. banking agencies Basel III Final Rule, assets and credit equivalent amounts of off-balance sheet exposures are calculated according to the standardized approach for risk-weighted assets. The resulting values are added together in the Bancorp s total risk-weighted assets.

(h) Excludes unrealized gains and losses.

Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

OVERVIEW

Fifth Third Bancorp is a diversified financial services company headquartered in Cincinnati, Ohio. At March 31, 2018, the Bancorp had $141.5 billion in assets and operated 1,153 full-service banking centers and 2,459 ATMs in ten states throughout the Midwestern and Southeastern regions of the U.S. The Bancorp reports on four business segments: Commercial Banking, Branch Banking, Consumer Lending and Wealth and Asset Management. The Bancorp also has an approximate 4.9% interest in Vantiv Holding, LLC. The carrying value of the Bancorp s investment in Vantiv Holding, LLC was $632 million at March 31, 2018.

This overview of MD&A highlights selected information in the financial results of the Bancorp and may not contain all of the information that is important to you. For a more complete understanding of trends, events, commitments, uncertainties, liquidity, capital resources and critical accounting policies and estimates, you should carefully read this entire document as well as the Bancorp s Annual Report on Form 10-K for the year ended December 31, 2017. Each of these items could have an impact on the Bancorp s financial condition, results of operations and cash flows. In addition, refer to the Glossary of Abbreviations and Acronyms in this report for a list of terms included as a tool for the reader of this quarterly report on Form 10-Q. The abbreviations and acronyms identified therein are used throughout this MD&A, as well as the Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements.

Net interest income, net interest margin, net interest rate spread and the efficiency ratio are presented in MD&A on an FTE basis. The FTE basis adjusts for the tax-favored status of income from certain loans and securities held by the Bancorp that are not taxable for federal income tax purposes. The Bancorp believes this presentation to be the preferred industry measurement of net interest income as it provides a relevant comparison between taxable and non-taxable amounts. The FTE basis for presenting net interest income is a non-GAAP measure. For further information, refer to the Non-GAAP Financial Measures section of MD&A.

The Bancorp s revenues are dependent on both net interest income and noninterest income. For the three months ended March 31, 2018, net interest income on an FTE basis and noninterest income provided 52% and 48% of total revenue, respectively. The Bancorp derives the majority of its revenues within the U.S. from customers domiciled in the U.S. Revenue from foreign countries and external customers domiciled in foreign countries was immaterial to the Condensed Consolidated Financial Statements for the three months ended March 31, 2018. Changes in interest rates, credit quality, economic trends and the capital markets are primary factors that drive the performance of the Bancorp. As discussed later in the Risk Management section of MD&A, risk identification, measurement, monitoring, control and reporting are important to the management of risk and to the financial performance and capital strength of the Bancorp.

Net interest income is the difference between interest income earned on assets such as loans, leases and securities, and interest expense incurred on liabilities such as deposits, other short-term borrowings and long-term debt. Net interest income is affected by the general level of interest rates, the relative level of short-term and long-term interest rates, changes in interest rates and changes in the amount and composition of interest-earning assets and interest-bearing liabilities. Generally, the rates of interest the Bancorp earns on its assets and pays on its liabilities are established for a period of time. The change in market interest rates over time exposes the Bancorp to interest rate risk through potential adverse changes to net interest income and financial position. The Bancorp manages this risk by continually analyzing and adjusting the composition of its assets and liabilities based on their payment streams and interest rates, the timing of their maturities and their sensitivity to changes in market interest rates. Additionally, in the ordinary course of business, the Bancorp enters into certain derivative transactions as part of its overall strategy to manage its interest rate and prepayment risks. The Bancorp is also exposed to the risk of loss on its loan and lease portfolio, as a result of changing expected cash flows caused by borrower credit events, such as loan defaults and inadequate collateral.

Noninterest income is derived from service charges on deposits, wealth and asset management revenue, corporate banking revenue, card and processing revenue, mortgage banking net revenue, net securities gains or losses and other noninterest income. Noninterest expense includes personnel costs, net occupancy expense, technology and communication costs, equipment expense, card and processing expense and other noninterest expense.

Vantiv, Inc. and Vantiv Holding, LLC Transactions

On January 16, 2018, Vantiv, Inc. completed its previously announced acquisition of Worldpay Group plc. with the resulting combined company named Worldpay, Inc. As a result of this transaction, the Bancorp recognized a gain of $414 million in other noninterest income during the first quarter of 2018 associated with the dilution in its ownership interest in Vantiv Holding, LLC from approximately 8.6% to approximately 4.9%. The Bancorp s remaining interest in Vantiv Holding, LLC of $632 million continues to be accounted for as an equity method investment given the nature of Vantiv Holding, LLC s structure as a limited liability company and contractual arrangements between Vantiv Holding, LLC and the Bancorp.

Accelerated Share Repurchase Transactions

During the three months ended March 31, 2018, the Bancorp entered into or settled accelerated share repurchase transactions. As part of these transactions, the Bancorp entered into forward contracts in which the final number of shares delivered at settlement was based generally on a discount to the average daily volume weighted-average price of the Bancorp s common stock during the term of the repurchase agreements. For more information on the accelerated share repurchase program, refer to Note 14 of the Notes to Condensed Consolidated Financial Statements. For a summary of the Bancorp s accelerated share repurchase transactions that were entered into or settled during the three months ended March 31, 2018, refer to Table 2.

Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

TABLE 2: Summary of Accelerated Share Repurchase Transactions

Repurchase Date	Amount ($ in millions)	Shares Repurchased on Repurchase Date	Shares Received from Forward Contract Settlement	Total Shares Repurchased	Settlement Date
December 19, 2017	$ 273	7,727,273	824,367	8,551,640	March 19, 2018
February 12, 2018	318	8,691,318	1,015,731	9,707,049	March 26, 2018

Senior Notes Offering

On March 14, 2018, the Bancorp issued and sold $650 million of 3.95% senior fixed-rate notes, with a maturity of ten years, due on March 14, 2028. These notes will be redeemable by the Bancorp, in whole or in part, on or after the date that is 30 days prior to the maturity date at a redemption price equal to 100% of the principal amount of the notes to be redeemed plus accrued and unpaid interest thereon to, but excluding, the redemption date.

Earnings Summary

The Bancorp s net income available to common shareholders for the first quarter of 2018 was $689 million, or $0.97 per diluted share, which was net of $15 million in preferred stock dividends. The Bancorp s net income available to common shareholders for the first quarter of 2017 was $290 million, or $0.38 per diluted share, which was net of $15 million in preferred stock dividends.

Net interest income on an FTE basis (non-GAAP) was $999 million and $939 million for the three months ended March 31, 2018 and 2017, respectively. Net interest income was positively impacted by an increase in yields on average loans and leases of 42 bps and an increase in average taxable securities of $1.3 billion for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. Additionally, net interest income was positively impacted by the decisions of the FOMC to raise the target range of the federal funds rate 25 bps in June 2017, December 2017 and March 2018. These positive impacts were partially offset by increases in the rates paid on average interest-bearing core deposits, average long-term debt and average other short-term borrowings for the three months ended March 31, 2018 compared to the three months ended March 31, 2017. Net interest margin on an FTE basis (non-GAAP) was 3.18% and 3.02% for the three months ended March 31, 2018 and 2017, respectively.

Noninterest income increased $386 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017 primarily due to an increase in other noninterest income. Other noninterest income increased $383 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017 primarily due to the gain related to Vantiv, Inc s acquisition of Worldpay Group plc. and an increase in private equity investment income, partially offset by an increase in the loss on the swap associated with the sale of Visa, Inc. Class B Shares, a reduction in equity method income from the Bancorp s interest in Vantiv Holding, LLC and an increase in the losses on disposition and impairment of bank premises and equipment.

Noninterest expense increased $60 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017 primarily due to increases in personnel costs, technology and communications expense and other noninterest expense. Personnel costs increased $35 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017 primarily driven by increases in base compensation, variable compensation and severance costs, partially offset by a decrease in medical expenses. Technology and communications expense increased $10 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017 driven primarily by increased investment in regulatory, compliance and growth initiatives. Other noninterest expense increased $16 million for the three months ended March 31, 2018 compared to the three months ended March 31, 2017 primarily due to increases in marketing expense and impairment on affordable housing investments, partially offset by a decrease in professional service fees and an increase in the benefit from the reserve for unfunded commitments.

For more information on net interest income, noninterest income and noninterest expense, refer to the Statements of Income Analysis section of MD&A.

Credit Summary

The provision for loan and lease losses was $23 million and $74 million for the three months ended March 31, 2018 and 2017, respectively. Net losses charged-off as a percent of average portfolio loans and leases were 0.36% during the first quarter of 2018 compared to 0.40% during the first quarter of 2017. At March 31, 2018, nonperforming portfolio assets as a percent of portfolio loans and leases and OREO increased to 0.55% compared to 0.53% at December 31, 2017. For further discussion on credit quality, refer to the Credit Risk Management subsection of the Risk Management section of MD&A.

Capital Summary

The Bancorp s capital ratios exceed the well-capitalized guidelines as defined by the PCA requirements of the U.S. banking agencies. As of March 31, 2018, as calculated under the Basel III standardized approach, the CET1 capital ratio was 10.82%, the Tier I risk-based capital ratio was 11.95%, the Total risk-based capital ratio was 15.25% and the Tier I leverage ratio was 10.11%.

Management s Discussion and Analysis of Financial Condition and Results of Operations (continued)

NON-GAAP FINANCIAL MEASURES

The following are non-GAAP measures which provide useful insight to the reader of the Condensed Consolidated Financial Statements but should be supplemental to primary U.S. GAAP measures and should not be read in isolation or relied upon as a substitute for the primary U.S. GAAP measures.

The FTE basis adjusts for the tax-favored status of income from certain loans and securities held by the Bancorp that are not taxable for federal income tax purposes. The Bancorp believes this presentation to be the preferred industry measurement of net interest income as it provides a relevant comparison between taxable and non-taxable amounts.

The following table reconciles the non-GAAP financial measures of net interest income on an FTE basis, interest income on an FTE basis, net interest margin, net interest rate spread and the efficiency ratio to U.S. GAAP:

TABLE 3: Non-GAAP Financial Measures - Financial Measures and Ratios on an FTE basis

($ in millions)		For the three months ended March 31, 2018		2017
Net interest income (U.S. GAAP)	$	**996**		933
Add: FTE adjustment		**3**		6
Net interest income on an FTE basis (1)	$	**999**		939
Net interest income on an FTE basis (annualized) (2)		**4,052**		3,808
Interest income (U.S. GAAP)	$	**1,206**		1,086
Add: FTE adjustment		**3**		6
Interest income on an FTE basis	$	**1,209**		1,092
Interest income on an FTE basis (annualized) (3)		**4,903**		4,429
Interest expense (annualized) (4)	$	**852**		621
Noninterest income (5)		**909**		523
Noninterest expense (6)		**1,046**		986
Average interest-earning assets (7)		**127,546**		125,968
Average interest-bearing liabilities (8)		**87,607**		84,890
Ratios:				
Net interest margin on an FTE basis (2) / (7)		**3.18**	%	3.02