Notes from the Ambassador Bank Vault **November 21, 2016**

Highlights From The KPMG 2016 Banking Symposium

We recently attended KPMG's annual banking symposium in Philadelphia and left with the sense that community banks have learned to cope with the numerous industry challenges. Balance sheets are arguably stronger than ever; and banks' profitability could improve significantly if regulatory relief and tax reform occur under the Trump Administration. The use of technology needs to expand if banks expect to attract and retain millennials (people born between 1981 and 2000) who represent the nation's largest generational group.

- The KPMG annual seminar provided industry color from the accountant/auditor perspective. The seminar, which attracted approximately 150 attendees, was geared to accounting, legislative, and regulatory developments, which are likely to most affect community banks.

- Regulatory challenges include the need to (1) strengthen corporate governance and culture and (2) improve data quality for budgeting and reporting purposes. Regulators seemingly differentiate very little between big and small banks, which makes little sense.

- A representative from the Office of the Comptroller of Currency (OCC) opined that credit risk is building and banks are exhibiting a stronger "risk appetite" for growth, particularly for commercial loans. Among the OCCs concerns are commercial real estate loan concentrations among community banks, more loan originations as "exceptions to policy", and weaker auto loan and credit card performance.

- The OCC representative also noted that loan loss reserve ratios continue to be lowered. We noticed that this was also cited at the KPMG 2015 Banking Symposium.

- The representative from the Chief Accountant's Office in the Securities Exchange Commission (SEC) provided detail regarding loan loss reserves. The SEC does not regulate the level of the loan loss allowance, but is concerned with the process that determines overall credit risk. There was also a mention of the need for more disclosure regarding non-GAAP data vs. GAAP reporting in public documents.

- The implementation of the Current Expected Credit Losses (CECL) model is expected to occur after December 15, 2019 for SEC filers. All other filers have an additional year. This accounting method, which takes into account expected losses over the life of the loan of both non-impaired loans and investment securities is a significant change over the incurred loss model.

- CECL will likely place more reliance on qualitative, or judgmental, factors, vs. the incurred method.

- The establishment of CECL should necessitate higher initial reserves than the incurred method, but it does not appear that current SEC policies will not encourage banks to boost reserves today, despite the OCCs warnings of growing credit risk.

Please feel free to contact Rick Weiss at 610.351.1633 or rweiss@ambfg.com with questions or comments.