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Notes from the Ambassador Bank Vault **November 15, 2017**

Highlights from the KPMG 2017 Banking Symposium

We attended KPMG's annual banking symposium in Philadelphia yesterday, and left with the sense that balance sheets are arguably stronger than ever, but banks' future profitability depends more on technology to attract and retain customers. Regulatory and accounting issues will continue to command much management attention.

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

- There isn't much variance among the return on equity ("ROE") for money center and regional banks, which suggests that the industry is challenged to find strategies to deliver superior returns.

- Outside of tax reform, a KPMG representative opined that boosting ROE requires further cost cutting along with leveraging technologies to provide comprehensive customer services and products. The banking industry's use of technology to win customer loyalty and business appears to lag that of other industries.

- An Office of the Comptroller of Currency (OCC) report dated January 2017, highlighted that strategic risk remains high for many banks as management teams seek new strategies to better compete in the low interest rate environment. The report added that "the failure to innovate to meet evolving needs of financial services may place a bank at a competitive disadvantage".

- Because cyber-security demands more than a defensive strategy, management time and technology costs are ongoing, rather than one-time events. Banks must contend with an increasingly complex regulatory environment, a shortage of IT talent, and possible over-reliance on third party vendors. Data breaches are likely to lead to reputational risk, regulatory fines, and additional expenses in order to fix systems.

- Several industry observers noted that credit quality remained very good through the third quarter of 2017 and probably couldn't get much better.

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

- The adoption of CECL will impact loans and investment securities accounted as Held To Maturity (HTM). Securities portfolios will be modeled on a collective basis; and not as individual securities.

- CECL will likely place more reliance on qualitative, or judgmental, factors, vs. the incurred method. The establishment of CECL should necessitate higher initial reserves vs. the incurred method, but it appears that SEC policies do not encourage banks to lift reserves today, despite the OCCs warnings of growing credit risk.

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