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## BANKING &amp; FINANCE

## Annual Banking Outlook Conference Highlights Opportunities, Challenges Facing the Banking Industry

March 30, 2017



On February 23, the Atlanta Fed's supervision and regulation division hosted the annual Banking Outlook Conference. The conference's theme, "Looking Back and Shifting Forward," was particularly appropriate given the changing of the guard in Washington DC. Challenges and trends in bank operations were discussed at the conference, which drew 120 guests.

Attendees heard that a loosening of regulation could be on the horizon for U.S. banks now that the industry is on sounder footing and the economy is stronger, but rising interest rates will boost costs and likely spur more mergers. Speakers also discussed the economic landscape, including reasons for optimism, with cautionary notes on balancing policy ambition with policy discipline, health care costs, immigration and trade. The day ended with a discussion of "transformative trends" in the global economic and political environments.

### Former Atlanta Fed president reflects on banking trends

Former Atlanta Fed President Dennis Lockhart, who ended a 10-year run as chief executive in February, shared his insider perspective on the Federal Reserve's response to the financial crisis, reflected on current conditions in the industry and discussed the future of central banking and supervision and regulation. His remarks were wide-ranging, frank, and informative.

"The banking industry is better off," said Lockhart. He said a lightening of regulation on banks is appropriate given the economy's cyclical recovery.

However, Lockhart said the nation's biggest banks that are important to the global financial system should face stricter regulatory requirements than regional and community banks. He advocated keeping "a great deal of the requirements on the largest banking institutions while being just a little bit more balanced about what's an appropriate posture of regulation and supervision for those that are not systemic."

Lockhart told the conference that it was important to have realistic expectations of the timing of regulatory relief, as any legislative changes would take time to roll out. He said he expects Dodd-Frank to be softened but not eliminated, adding that efforts to change the 2010 banking reform and consumer protection law could play out similarly to attempts to alter the Affordable Care Act, the 2010 healthcare law.

He said the bank failures that plagued the Southeast during the past decade were "somewhat idiosyncratic" to the region, with a lot of new banks' focus on residential business. "The banks were just far too concentrated in one asset category," he said.

Higher interest rates will make banking a more expensive business, increasing the probability for mergers, Lockhart said. An impromptu poll of the audience found that most respondents expect two increases in the federal funds rate this year.

"I think the industry will probably continue to consolidate," Lockhart said. Compliance costs and requirements for banks will continue to be higher even if they soften a bit from the pre-crisis period, he added.

## **Broad banking trends populate conference presentations**

Christopher Marinac, senior managing principal and director of research at FIG Partners, an investment banking and research firm, said some merger activity in recent months has been driven by banks looking to increase their core funds on hand. "As interest rates rise, that's going to change the cost of funds," Marinac said. "If companies want to capture potentially better margins in the future, they have to start with core funding."

As banks look to differentiate themselves with customers, technology can help. Financial technology companies are partnering with banks, providing services such as cash management, Marinac said.

As more people bank online, brick-and-mortar establishments still have an important role. "The challenge in the industry right now is rationalizing the staffing," said Jim McAlpin Jr., partner and leader of the financial services group at the law firm of Bryan Cave. "Commodity products need to be more automated. You need to shift your people to the higher-margin product lines."

Wayne Abernathy, executive vice president for financial institutions policy and regulatory affairs at the American Bankers Association, cited optimism about the potential for the bank regulatory environment to soften. He said a move toward relaxing paperwork for bank regulation that began under the Obama administration would likely accelerate under the leadership of President Donald Trump. Bank regulators recognize that reforms spurred by the financial crisis have created "thousands of pages of regulations" that are overburdening their staffs, Abernathy said. "They need simplification as much as we do," he added.

Additionally, some of Trump's new executive orders and memos will likely be significant for the industry, Abernathy said. Though a memo that froze hiring for some federal workers doesn't directly affect bank regulators, both the Federal Reserve and Office of the Comptroller of the Currency signaled they would follow the spirit of the order, Abernathy said. Trump's order requiring the elimination of two regulations for each new one that is added was met with a similar response from bank regulators. "The sense is it's a time of significant reform," Abernathy said.

## **Policy changes can reverberate**

Even so, an economist cautioned that policy changes on healthcare, immigration, trade, and taxes could have unfavorable economic consequences.

Carl Tannenbaum, executive vice president and chief economist at Northern Trust, said Congress will need to keep health care costs under control as it weighs replacing or repealing the Affordable Care Act, which provided medical coverage for 20 million additional Americans. Noting that the Affordable Care Act did "put a little bit of a cap" on medical costs, Tannenbaum stated that even incremental increases in healthcare costs "could be very detrimental to the long-term budget."

He also said that immigration, which is currently a topic of national discussion, was essential to economic growth. "We are going through a period where our population growth is very, very slow, and the data show us that the labor force growth that we've had has been weighted disproportionately to first- and second-generation immigrants to the United States," Tannenbaum said.

Tannenbaum said Trump will have an opportunity to make appointments to agencies such as the Commodity Futures Trading Commission, Securities and Exchange Commission, and the Federal Reserve, which will soon have three vacancies on its Board of Governors once Daniel Tarullo departs in April. Tannenbaum stressed the importance for new board members to have an open mind and embrace a spirit of collaboration.

"The independence of our central bank, to lean against excesses of inflation and asset prices, is something that all of us should be very serious about," Tannenbaum said. "Without it, the checks and balances in our economy may not be as strong and the outcomes may be more extreme."

Here are other takeaways from the conference:

- Ed O'Boyle, global practice leader with Gallup Inc., presented poll findings that showed although economic confidence is rising and consumers are spending more, trust in institutions such as banks is low, and engaging the millennial customer is challenging. He also said bank employees are the key to unlocking brand potential and drawing new customers.
- Lockhart said the Federal Reserve balance sheet, which has swelled to \$4.5 trillion from below \$1 trillion in 2008, is likely to shrink over the next several years. He predicted that the balance sheet will settle in the \$1.5 trillion to \$2 trillion range.
- Home price growth is steady heading into the spring, but rising interest rates could dampen sales of previously owned houses, according to a presentation from CoreLogic Deputy Chief Economist Sam Khater. The inventory of affordable homes is low and declining.
- David Kohl, Professor Emeritus, Virginia Tech University, and Thomas Payne, Dean, College of Business at Tennessee Tech University, closed the conference with a discussion of "transformative trends" in the global economic and political environments, including risks faced by national policymakers and implications for the Southeast.

Some of the remarks and presentations made at the conference [are available](#) for reading or downloading.



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