2017: A Brief Recap and the Effect on Financial Institutions

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Perhaps the biggest story of 2017 focused on President Trump and the assembly of his Administration. Trump's Administration transitioned into the White House at the end of January with an ambitious pro-growth agenda. Most recently, the Administration notched a win by passing the largest overhaul of taxes since Ronald Reagan. Behind the scenes, his Administration has been working on cutting regulatory burdens, specifically financial regulations. Only history will tell how successful these two policies are at delivering growth. In other economic news, the stock market continued its historic ascent to new all-time highs, along with an estimated 2.5% GDP growth for 2017, and historically low unemployment. Due to the perception of a stronger economy, the Federal Reserve raised interest rates three times with plans for additional rate hikes in 2018.

Federal Open Market Committee (FOMC) - Rate Hikes

The FOMC continues to provide clear communication regarding rate intentions coupled with controlled execution, resulting in stability and methodical reaction by the financial community. Once financial institutions felt there was a sense of direction, they began to take a more proactive approach in adjusting rates. This was not the case during the first two rate increases, as financial intuitions were trying to recoup depressed margins and monitor the effects that the increase had on the economy. However, as increased rates have prorogated throughout the remainder of the fixed income market, financial institutions have actively adjusted rates to maintain depositor balances. With the prospect of further rate hikes in 2018 and strong economic growth, financial institutions will have to continue actively pricing deposit options in order to maintain deposit balances.

Regulatory Factors

Under the previous Administration, financial institutions faced ever-expanding regulations. However, since President Trump has assumed office, he has tasked Treasury Secretary Steve Mnuchin to focus on lessening the burden on financial institutions; specifically community banks and credit unions.

Some of the goals outlined by the Treasury Department are:

- Avoid a one-size-fits all system by simplifying capital requirements for small and mid-sized credit unions
- Tailor regulation to reduce unnecessary burdens and costs
- Reduce regulatory overlap by federal agencies
- Improve the competitiveness of US banks on the global stage

Financial institutions, especially community banks and credit unions, have been anxiously awaiting regulatory relief; however significant resources have already been deployed which will continue to weigh on community banks for years to come. In general, over the past year there has been a feeling of hope by financial institutions. If the Trump Administration is successful in reducing the regulatory burdens for financial institutions, they'll be able to allocate more resources to making loans and supporting the community, which should stimulate growth.

Tax Factors

At the end of 2017, a historic tax reform bill was passed which lowers the tax rate on corporations to 21% from 35%. Although the lower tax rate will benefit financial institutions in the long run, there is a bit of anxiety in the short term. With the reduction of the corporate tax rate, the value of tax-deferred assets will be lower, forcing write-downs. For example, Citigroup estimates an approximate $16 billion write-down. Since deferred tax assets are generated through loan loss reserves, it is estimated the vast majority of financial institutions will be affected by this.

Conclusion

From a financial institution perspective, 2017 provided hope on a number of fronts. The Federal Reserve has signaled their desire to return interest rates to a more "normal" level, which should allow institutions to increase margins. A regulatory framework that is designed to provide relief should allow community banks and credit unions to grow loan balances and open up new business opportunities. Lastly, tax reform should stimulate growth by freeing up capital. Only history will tell the true impact, but in the near term, the future looks optimistic for financial institutions.

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network, Inc. and PMA Securities, Inc. where he oversees PMA Funding., a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 50, 53, 63, 65 and 99.

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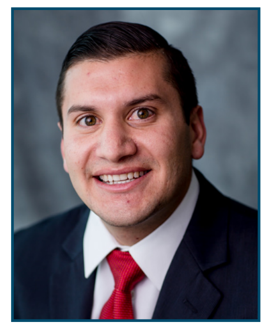

Todd joined PMA Financial Network, Inc. in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing financial institution partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.