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Pennsylvania Association of Community Bankers

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Testimony Of

Pennsylvania Association of Community Bankers

Before The

Senate Banking and Insurance Committee

Concerning:

Competitiveness of Pennsylvania's Taxpaying Financial Institutions

Presented By

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Chairman White, Chairman Smith, and members of the committee, thank you for the opportunity to come before you and talk about an issue that is near to my heart; community banking. My name is Jane Crawford and I serve as the Senior Vice President at Indiana First Bank where I am responsible for risk and regulatory compliance. I am here today testifying on behalf of the Pennsylvania Association of Community Bankers, or PACB for short, which Indiana First is a member. I appreciate the committee holding this hearing to address this issue of competitiveness of the banking industry in the Commonwealth.

I have been involved with community banking for 44 years in a variety of capacities having started my career as a teller in my home town of Erie, Pennsylvania. I spent 25 years in compliance and 10 years overseeing bank operations for small and mid-size community banks in Pennsylvania and Ohio. Earlier in my career my duties included internal auditing, branch management, consumer lending and subject matter expert for mergers and acquisitions. I joined Indiana First Bank in February of 2013.

One thing that has not changed in all of the time I have been with a community bank is the emphasis on relationship banking. That term "relationship" gained popularity in the nineties but all community bankers know our business model has always been customer based on a personal level. That is how the mutual community banking industry operated from its inception with the first Building and Loan in 1831, the Oxford Provident Building Association here in Pennsylvania.

The good that community banks do in their communities through project sponsorship, volunteering and helping neighbors is a value that can't be put on a balance sheet. Community banks are uniquely positioned to help identify the problems of concern in a community and work collaboratively with local leaders to progress forward.

<u>Pennsylvania's Taxpaying Financial Institutions</u>

Pennsylvania is fortunate to be home to a diverse financial service industry serving the financial needs of the state's citizens. Moreover, Pennsylvania has a robust community banking industry with 156, or roughly 82%, of the FDIC financial institutions operating in Pennsylvania having assets totaling $1 billion or less. There are an additional 29 community banks with assets ranging from $1 billion to $10 billion that provide services for their communities in the state.

While many in the public may categorize all banks the same, the fact is that community banks are quite unique from the Wall Street banks that nearly toppled our economy 7 years ago. Ask anyone their personal opinion on banks, in general terms, and they will likely respond with a neutral to negative viewpoint. However, when you ask them about their local community banks they'll speak of their community involvement and support of local philanthropic efforts.

Community banks on the national level hold approximately 15% of total deposits but they are the leader when it comes to small business lending. FDIC and SBA data routinely shows that community banks, defined as institutions under $10 billion in assets, are responsible for making nearly 60% of all small business loans less than $1 million. That is also the case in Pennsylvania where community banks have dynamic commercial lending portfolios aimed at growing local business.

Our portfolio of commercial loans is direct evidence that small business lending is a profitable market niche for community banks. Because of our hands on approach we have a comparative advantage in originating and monitoring small business loans compared to larger banking organizations. Our loan portfolio grows every year and the customers we have often refer us additional business because they know we are pro-active in meeting their needs through the application process and beyond. Many of the commercial customers we service tell us that the large regional banks seldom return their calls or simply do not want to perform the work for a loan which seems minimal to them. We understand that any business loan is critical to the customer and to our community at large. We service 1,233 commercial loans averaging $84,565 within our defined lending area.

A program we are very proud of, established in 2006, is our Amish/Mennonite Lending program. Because these loans are non-conforming and have many special features we established a loan program designed to meet their needs working closely with the Bishops and Elders of the church. It is clear, without community bank involvement this segment of the population would be underserved and a missed opportunity for commerce in small rural towns. Currently we have 291 loans with an average balance of $65,156.

Understanding Mutual Banks

Indiana First Bank is a mutual institution that is not "owned" by any interest. Indiana, along with 46 other institutions in the state, are unique in their governance structure operates as a cooperative. Mutual banks primary responsibility is to the in which community they operate. Traditional banking services are the core of mutual institutions with an emphasis on deposit accounts, mortgage loans, and small business loans.

We are proud of the fact that we are able to reinvest directly into the community with local lending activity. Pennsylvania has the 4th most number of mutual institutions headquartered in the state.

Mutual institutions have traditionally had strong levels of capital in order to remain solvent during times of economic stress. If you look at the average age of the mutual operating in the state you will see that many of them precede the Great Depression and have always been regarded as a safe place for depositors to place their money. During the recent recession when there was an increase in bank failures across the nation only 12 of the institutions that failed were mutual banks.

Credibility and Commitment to Our Community

Because we are so rooted in our community we are constantly pursuing opportunities where we can encourage responsible financial decision-making, especially when it comes to our younger citizens. Indiana First Bank has a history supporting financial literacy in the communities we serve. A long time program sponsored by the County of Indiana called "CIRCLES" offered classes to help low to moderate citizens rebuild their credit. That program is being redesigned as I speak.

It will become more encompassing including budgeting and finance. The Branch Managers of the bank visit local schools and organizations with a program called: "Teaching Children to Save." Some classes are done on-site at the bank giving the children a tour of the facilities and current technology. The bank has also embraced technology with our "Technology Centers" being put in the lobbies of our branch locations. Consumer can come in, sit down use a tablet device and if needed, print documents while enjoying a cup of coffee. We are there to assist them with the technology learning curve. The "Tech Centers" also help to fill a void for a very large Mennonite and Amish customer base.

This year will be the "Fourth Annual Indiana First Bank Veteran's Marathon, Half Marathon, and Marathon Relay," benefiting Indiana County Veterans. Over $40,000 has been raised in the past three years and the race now has the designation of being a Boston Marathon qualifier.

Indiana First Bank was also a major contributor to the "2015 Miracle League of Indiana County," a baseball field providing the opportunity for people with special needs a chance to experience playing baseball in a league-based environment.

The Salvation Army "Red Kettle Kick-off Breakfast" was underwritten by Indiana First Bank. This event was the second most successful event in the country with New York City placing first.

As part of the building project, the Indiana Regional Medical Center complex will acquire new operating room suites; a new intensive care unit and many other enhancements to the surgical unit. Again, Indiana First Bank has supported this endeavor benefitting the community with a substantial donation over the next five year period.

Other contribution such as the Indiana University Scholarship Fund, local school sponsorships, charitable events and local community events means thousands of dollars in much needed community support.

<u>Competitiveness Issues and Regulatory Obstacles for Mutual Institutions</u>

It is difficult to compare the tax rate for Pennsylvania mutual institutions against other states because of the varying methods for assessing a tax including some regimes involving net income, deposits or assets, bank shares, or some combination of the above measures. However, there is data to support the assertion that Pennsylvania banks pay a higher effective tax rate than banks operating in contiguous states. As an association, PACB opposes any tax increase on taxpaying banks without first addressing the issue of entities operating in a similar capacity not subject to comparable taxation.

Mutual institutions in Pennsylvania are taxed under the Mutual Thrift Institutions Tax (MTIT), rather than the Bank Shares Tax which applies to commercial banks operating in the state. Currently the tax rate for mutual institutions is 11.5% of net earnings or income received. This is in addition to the federal graduated tax rate of up to 39%.
Under this tax structure, for every dollar of income that is earned, taxes account for nearly half that amount.

This unfavorable tax climate in which Pennsylvania banks operate has only been exacerbated by the flood of regulations promulgated by federal agencies such as the Consumer Financial Protection Bureau. These regulations are problematic in that they are "one size fits all" and hold smaller institutions to the same standard as national and international banks.

Recent regulatory developments in Washington have required banks to retain record high levels of capital to account for the shortcomings of some institutions during the great recession. Unlike commercial banks, mutual banks cannot simply raise capital through a stock offering but must rely on retained earnings as a primary source for Tier 1 capital. The typical mutual bank's capital level is between 12 and 13%; which is above what has been proposed under the international banking agreement known as Basel III. Still this remains of concern to mutual banks because of the difficulty to raise capital and the continued need to make credit available to the community. The more capital that regulators require restricts growing our lending portfolio as well as limiting a source of funds for sponsorship of community events or for other charitable purposes.

Another issue of concern for mutual institutions is the restricted ability to respond to consumers in order to maintain financial stability. In the past, if a troubled homeowner was having trouble making mortgage payments due to unexpected circumstances like the loss of a job or a major illness, community banks were well positioned to be able to work with that consumer on a one to one level because of the already established relationship. A long time customer of the bank needing a small dollar loan to make a car repair could previously call or visit his or her local branch, fill out a form or make a handshake arrangement, and have the car back in service the next day.

Now however, federal regulations have handcuffed banks' ability to work with consumers on a case-by-case basis. Regulations today require that if a modification or exemption is made for one person it must be applied to all customers, even in circumstances where the consumer may not have a need. Case-in-point, a bank identified 65 loan customers who were struggling within the 30 day delinquent window. The bank proposed modifying the loans by lowering the rate. The request was not customer generated but the result of the bank seeing a theme within their loss mitigation summary. The bank could not get regulatory approval because of possible Unfair, Deceptive or Abusive Acts and Practices. The community-banking model is grounded in responding to the needs of our customers and acting proactively. One size fits all regulation does not account for this business model and prevents community bankers from making decisions concerning risk.

It used to be that community banks were permitted to use discretion based on their relationship with customers to find mutually agreeable terms that were fair for both parties. Now, there are hundreds of disclosures required that can be intimidating for the first time homebuyer or someone opening a new account. I took my first mortgage application in 1973 at Marquette Savings and Loan, in Erie, Pennsylvania. The paperwork consisted of an application, Good Faith Estimate, sales agreement and two recent pay stubs. The customer's signatures were required on only the formal application. Today, that same 20% down conventional purchase-money loan would require 32 signatures on various disclosures and required forms in order to begin the loan process.

<u>Emerging Challenges for the Banking Industry</u>

It is no surprise that technological advances have redefined the traditional banking industry in recent years. New and emerging players have entered the lending field including peer to peer lenders, crowd-funding and other internet based services, and other unregulated "shadow banking" entities. The energy and excitement that comes with marketplace advancement is welcomed by the community banking industry, but it does not come without its own new set of issues.

Recent discussion about the emergence of virtual and crypto currencies, such as Bitcoin, has prompted conversation about allowing for innovation, while still effectively balancing the need for security and stability for our banking system.

Whereas banks must abide by regulatory requirements concerning underwriting loans and assessing risk, these new entities operate without the same regulatory requirements. While some may laud the convenience of these new entities, it is not always in the best interest of consumers.

To provide a recent example from an institution in the state, a small business in the construction field came to a community bank for a business line of credit because of anticipated payroll costs. The bank had a relationship with the customer and began its due diligence making sure the line of credit would make sense for all parties and that the line of credit would adhere to regulatory guidelines.

As the bank was processing the line of credit, about two weeks' time, the business made a decision it needed immediate access to credit and found a "loan" with little to no questions asked from a lender that was not part of the traditional lending industry. The non-traditional lender promised instant access to credit.

This loan, accounting for the terms and conditions, carried an interest rate of over 80% per annum. The non-traditional lender was not required to be licensed by any state or federal regulator so the customer could seek little recourse.

We are not suggesting that these industries not be available to consumers. However, if these entities are going to offer products and services that are available at a traditional bank, there must be a willingness and obligation on their part to compete on a level playing field. Banks are not averse to competition and nearly every banker you speak to will welcome open competition that is done with the same rules being applied to all parties.

Closing Remarks

I would encourage each of you, for those that may have not yet done so, to take time to sit down with your local community bank Presidents and CEOs and learn about the projects they are involved with throughout your district.

You may be surprised at your local bank's level of community involvement and the many projects they are proud to stand up and support. Thank you again for the opportunity to testify before you today and I'm happy to respond to any questions or comments you may have.