Testimony of

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On behalf of the

Pennsylvania Association of Community Bankers

Before the

United States Senate
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Financial Institutions and Consumer Protection

Hearing on

"The State of Rural Banking: Challenges and Consequences"

Wednesday, October 28, 2015
10:00 A.M.
Washington, D.C.

Chairman Toomey, Ranking Member Merkley, and members of the Committee, my name is Terry Foster. I serve as Executive Vice President and CEO of MCS Bank (Mifflin County Savings Bank), a $137 million dollar asset bank headquartered in Lewistown, Pennsylvania. We are a state-chartered mutual savings bank, which was originally chartered in 1923 as Mifflin County Building and Loan Association. Our bank serves exclusively rural populations in the central part of the state, with a market area primarily defined as Mifflin, Snyder and Huntingdon Counties. I have served in my current role at MCS Bank since 2009, but I have served the bank in other capacities for the past twenty (20) years. I am a locally-raised banker who grew up in a community long served by MCS Bank and my connection to the bank started many years earlier when I opened my first savings account in order to save monies I earned from a newspaper route and mowing lawns. In addition to my role at MCS Bank I also serve as the current Chairman of the Pennsylvania Association of Community Bankers (PACB) as well as serve on the Mutual Bank Council of the Independent Community Bankers of America (ICBA). I wish to thank you for convening today's hearing on "The State of Rural Banking: Challenges and Consequences" and providing me with the opportunity to testify.

I wish to state that my testimony is based upon my own experiences and observations as a rural community banker, as well as from the perspectives of my fellow bank employees' dealings with our customers and stakeholders. Further, my testimony is from the perspective of a $137 million institution trying to preserve its ability to survive and maintain a presence in communities where local banking and service is so very important; I hope to be able to illustrate this last point with an example in my testimony.

MCS Bank is headquartered in Lewistown, PA, the county seat of Mifflin County. The bank was originally formed as Mifflin County Building & Loan Association in 1923. In 1956, Mifflin County Building & Loan Association converted to Mifflin County Savings & Loan Association. In 1992 a final conversion occurred, creating Mifflin County Savings Bank (AKA MCS Bank). MCS Bank now operates five (5) full-service branches and one (1) loan operations office within the three–county market. Exclusive of our headquarters branch, the average size of our branch network is $12 million in assets. Within two (2) communities in which MCS Bank maintains branches, no other banking outlets exist. The Bank operates with a staff of forty-two (42) full and part-time employees, or 37 full-time-equivalent employees (FTEs).

The bank's market is comprised of an approximate 1,600 square-miles area with a population density of eighty-one (81) residents/square mile. Median household income across the market is $43.7 thousand, which is lower than both our state and the national figures. The percentage of persons below the poverty level is in line with the state average and below the national average. Population growth in our market is historically low, and has been nearly flat in more recent years.

By their nature, rural markets create unique efficiency challenges in terms of serving dispersed populations as compared to the more densely populated suburban and urban areas. The fact that MCS Bank, at just $137 million in assets, operates five (5) full-service branches to serve thinly served communities illustrates my point. Every dollar of cost rural institutions must incur to

maintain compliance with new or heightened regulatory requirements disproportionately impact institution like mine.

A unique population dynamic in our market, although not exclusive to us in the central part of Pennsylvania, but one that I feel is a perfect example of why it is critically important that independent community banks in rural markets survive, is the existence the unique populations that require unique servicing, in our case, the “plain sect” or Amish community.

For those committee members not familiar with the Amish and their unique traditions, they are a group of traditional Christian church fellowships of Anabaptist origins. The Amish live simple, agrarian existences, dress very plainly, avoid the use of most modern technologies, including electricity, telephones, automobiles and modern banking conveniences, such as web banking, and more recently, mobile banking. In place of traveling by automobile, Amish travel by horse-drawn “buggy”. Because of their social and religious conventions and aversion to technology, serving this demographic is difficult and it takes a keen, local understanding of this “community” to meet its members’ needs; a community that will never be understood by banks headquartered in suburban or urban centers and whose needs are not a part of the equation when branch consolidation or closure decisions are being contemplated.

Proof positive: in 2011, a large regional bank, serving a rural community in our market with a high concentration of Amish residents, shuttered a branch that long served that community. Over the years the branch had changed ownership through acquisitions by successively larger organizations. Ultimately, the branch, along with other branches in other rural communities, were closed as a result of the current bank’s internal “branch rationalization” process that concluded that the subject branches would not be retained due to size and other factors. What we learned at the time, anecdotally, was that the bank was closing rural branches that were under $15 million in size. In comparison, MCS Bank’s branch network averages $12 million in size. The loss of this branch was devastating to the community’s residents and businesses, particularly to the Amish residents whose transportation limitations created an unusual hardship by forcing them to travel long distances to another community to do their banking at a branch to which their account servicing was transferred.

In response to this community’s loss, MCS Bank worked with community leaders and business owners to try to find a workable solution to allow the community to retain its banking outlet. After a lengthy process, numerous fact-finding community meetings and mail surveys, the Bank partnered with a member of the business community to build and open a 530 square-foot branch within a building supply/hardware store. Four years later, this branch, albeit very small, is thriving and supporting the community. To date, the bank has provided financing to the Amish community for such projects as the purchase of land for farm expansion and for the construction of a new retail store.

The potential loss by this particular community is just one example of situations that are playing out in communities across the nation. I believe very strongly that the community banking industry is experiencing consolidation, particularly in rural markets, at an accelerating rate, for a host of reasons, but one being escalating compliance–related cost and complexity. Yet another occurrence of branch consolidation is taking place this very month within our market, which will

force customers of that bank to travel more than twenty (20) miles to the next closest bank branch.

At MCS Bank, we now have six (6) of forty-two (42) employees who devote significant amounts of their routine workdays to compliance; from our Compliance Officer down to lenders and loan processors.

I argue that a great deal of time and resources we are devoting toward our efforts to comply with the letter of the laws and regulations, their complexities and many inconsistencies, have had a detrimental impact on our ability to serve our customers with both products and service delivery.

Has Dodd-Frank impacted the products our bank offers? Yes. Since the introduction of QM and Ability-to-Repay, MCS Bank has discontinued offering balloon loans. For us, the decision wasn't a matter of whether or not we have the latitude within the new rules to continue to offer this product, but rather it boiled down to a matter of resource allocation. With the volume of rules to interpret and implement, we simply had to decide on which products we were going to focus our attention. Because we historically originate fewer balloon loans in comparison to our other mortgage products, we opted to not create a new note and disclosures, under the new rules. Secondarily, we were concerned about the potential higher level of examination scrutiny.

The required escalation of our compliance focus negatively impacts bank stakeholders such as community organizations, charities, etc., which have historically been the beneficiaries of our philanthropic efforts, both monetarily and otherwise. The more time our people must devote to compliance matters is less time available for them to spend on volunteer and charitable endeavors. Increased regulatory costs also negatively impact the community by way of diverting financial resources away from community investment. As increased costs and other pressures work collectively to incentivize further consolidation, larger organizations with distant headquarters locations lack the appreciation and commitment to local needs in rural areas. I know from personal experience of such situations in our market. In a community into which we are contributing thousands of dollars annually in charitable donations and other types of community giving, a large regional bank, by comparison, is contributing very little. We have a branch manager in our community office who previously worked in the same capacity for the regional bank, whose office was allocated only $100.00 annually for community support.

Are theories behind the consumer-focused regulations well intended? Absolutely! The notion of "ability-to-repay", as generally defined, has long been an underwriting practice of prudent community lenders, but the codification of such concepts into regulation is fraught with complexity, inconsistencies, and in some cases lacks logic. The unintended consequence is confusion for our people as they attempt to implement and administer new rules, which ultimately leads to human error, additional cost and potential examiner criticism, despite best efforts to do the right thing. I argue there are elements that have no meaningful benefit to consumers, and in fact create greater consumer confusion.

To the issue of human error, consider the following example we experienced in a purchase-mortgage transaction:

- In the sale negotiation, the buyer agreed to pay the full transfer tax to the county authority. The loan processor, when preparing the early disclosures, overlooked this detail when reviewing the Sales Contract. As a result, the early disclosure was prepared, as is customary, with the buyer and seller paying one-half each of the transfer tax. This error, when discovered, was not a redisclosable event under (RESPA Reform of 2010); therefore we could not reissue a revised early disclose to correct the error. Consequently, we absorbed the cost of one-half of the transfer tax by compensating the buyer for an expense he fully intended pay as a part of the negotiated transaction. Under the new TILA-RESPA Integrated Disclosure (TRID) rules, there remains no latitude for us to rectify this type of mistake, thus forcing cost onto the bank as a result of simple human error.

Because the timing of today's hearing coincides with our ongoing work to fully implement the rules promulgated by the TILA-RESPA Integrated Disclosure (TRID), which had an effective date of October 3, 2015, I have included a TRID related example in my testimony:

- One (1) of two (2) definitions of a Business Day apply for disclosure purposes depending upon the nature of the disclosure (Initial or Revised Loan Estimate, or Closing Disclosure).

- Formatting differences exist between the Loan Estimate and Closing Disclosure documents.

    - Estimated fees costs are required to be truncated on the Loan Estimate while they are required to be taken out to two (2) decimals on the Closing Disclosure (i.e. Estimated Taxes and Insurance must be disclosed as $xxx. on the Loan Estimate and as $xxx.xx on the Closing Disclosure, even when the estimates do not change from the time the Loan Estimate and Closing Disclosures are prepared and provided to the customer.

The complexity involved in implementing TRID is taxing all parties involved. In our case, our third-party Loan Origination Software (LOS) provider's applications were not ready to go on October 3rd; therefore our testing protocols were delayed. If fact, as of Friday of last week, our loan origination software is on its fifth (5th) update, post October 3rd, to correct a host of technical issues. Despite the amount of training our lending and compliance staff has attended to be ready for the changes, we were still not fully prepared to go on day one, which in my estimation is a function of over complexity of, and inconsistencies within, the rules. Director Cordray acknowledged the delays some of the vendors are experiencing in readying their platforms to handle the new TRID rules.[1]

As things stand now, in terms of product delivery, we are wrestling with whether or not the new rules will allow us to continue to offer single-closing construction loans when the customer chooses and adjustable-rate mortgage (ARM). Our compliance consultant with thirty (30) years of experience is of the opinion that the new disclosure rules do not accommodate a single-close

[1] ICBA Opposes CFPB Overdraft Data Request. (2015, October). ICBA Independent Banker, p.11

construction loan that has a variable-rate during the construction period then converts to an ARM loan when the loan enters the post-construction repayment phase. Single-close construction loans benefit consumers in terms of both time and cost. This inability to originate an ARM loan in this situation also reduces our ability to manage interest rate risk. In today's low rate environment, this is most critical.

As a small institution, not only do we rely on software vendors, but we also must rely on consultants for guidance and interpretations of the application of the rules. While working through TRID implementation and training, our compliance consultant cited instances in which requests to the CFPB staff for clarification have been met by being pointed back to the guidance. An example of this instance being the construction loan disclosure illustration previously cited.

The CFPB order, issued in 2014, to financial institution data processors to provide client bank overdraft program system settings and overdraft activity, for analytical purposes, imposes a real cost to community banks. Our data processor, Fiserv Inc., responded to this order by stating, "The request will impose significant expenses that will have to be passed to its bank clients."[2] The financial institution themselves, not CFPB, bear the cost of the data processors efforts to comply with the CFPB request in order that the Bureau may ferret out practices tied to "overdraft privilege programs" that it perceives as wholly bad for consumers.

At MCS Bank we've long held to a traditional approach to consumer overdrafts. Long ago our board and management team took a philosophical stance against "overdraft privilege programs" because we didn't want to create the perception with either regulators or customers that we encourage overdraft behavior for the sole sake of generating overdraft revenues. Our approach is simple: we work one-on-one with customers exhibiting overdraft behavior. We counsel those experiencing financial difficulty and attempt to provide assistance to redress the underlying issue. When we believe circumstances warrant closing an account and moving a customer to a more suitable account, we will do so.

There are several important issues related to the CFPB's order to the financial services third-party core processors to provide the requested data, such issues as authority and due process under § 1022 of Dodd-Frank. For our bank, the more basic issue is who ultimately bears the cost of compliance. Our data processor clearly has signaled it will pass the cost onto us; a cost that we will be forced to absorb. Unfortunately, we as an institution, and few other community bank institutions I know of, have never engaged in the type of behavior that gives the CFPB such concern.

Flood map "creep" in recent years has exposed MCS Bank to reputation damage, an instance of a formal consumer complaint being lodged with the Pennsylvania Department of Banking and Securities and ultimately a lost customer.

In 2013, a customer disputed a Flood Redetermination and refused to purchase flood insurance. The bank advised the customer of their need to obtain an elevation determination in order to

[2] Swanson, J. (2015, October 20). CFPB Warning: Cordray 'Disturbed by Reports' of TRID Implementation. (mortgagenewsdaily.com)

potentially avoid the need for flood insurance. In the interim, the bank forced placed insurance on the property to ensure coverage is in-place within 45-days of our receipt of the redetermination notice. The subsequent elevation determination concluded that the customer's home was not in a flood zone and thus flood insurance was not required. The bank promptly canceled the force-placed flood insurance and refunded the unearned premiums returned by the insurer. The customer then demanded a refund of the entire premium because of the elevation-determination results. Not being satisfied with the reason for a partial refund, the customer filed a complaint against the bank with the Pennsylvania Department of Banking and Securities. A review by the Department concluded that the bank acted properly. As you might imagine, this borrower no longer does business with MCS Bank.

Recommendations:

A number of bills have been introduced in the House and Senate that would provide significant relief from many of the concerns noted above:

S. 1711, introduced by Senators Tim Scott and Joe Donnelly, would provide a critical safe harbor from enforcement actions and private law suits for compliance errors arising from the implementation of the TRID rule, provided the lender has acted in good faith to implement and comply with the new rule. As with any new rule of this magnitude and complexity, before it went "live" on October 3, it was impossible for community banks and other stake holders to begin to identify problems and develop and implement solutions. This is particularly true because there was no opportunity under the new rule to comply early, testing systems in real time and under real circumstances. A safe harbor will allow mortgage closings to proceed apace without fear of enforcement and liability for minor errors.

The Financial Regulatory Improvement Act (S. 1484), introduced by Chairman Richard Shelby and marked up by this committee in May, contains a number of provisions that would help community banks like mine better focus our resources on the communities we serve. For example, S. 1484 would provide that any mortgage held in portfolio, including the balloon loans that play an important role in our local market, would be a "qualified mortgage" (QM), under the CFPB's ability-to-repay rule. The bill would also create an 18 month exam cycle and streamlined call reports for well-rated community banks with assets of less than $1 billion. These provisions would better reflect the significantly lower risk profile of community banks. S. 1484 would require the Federal Housing Finance Agency to withdraw a proposed rule that would impose a mortgage lending test on Federal Home Loan Bank (FHLB) members. The FHFA proposal cuts against the grain of Congress's clearly expressed intention of expanding the mission and role of FHLBs beyond residential housing finance to supporting small and medium sized businesses and other critical community needs. These are just a few of the more significant regulatory relief provisions of S. 1848.

S. 970, introduced by Chairman Pat Toomey and Senator Joe Donnelly, would allow a highly-rated bank (CAMELS 1 or 2) with assets of less than $1 billion to be examined on an 18 month rather than a 12 month cycle. S. 970, which is identical to a provision of S. 1484 noted above, would allow examiners to better target their resources at the true sources of systemic risk.

The Community Lending Enhancement and Regulatory Relief Act of 2015 (the "CLEAR Act", S. 812), introduced by Senators Jerry Moran and Jon Tester, would provide QM status for any mortgage held in portfolio and an exemption for loans held in portfolio from new escrow requirements for higher priced mortgages for any lender with less than $10 billion in assets. S. 812 would also provide an exemption from internal control attestation requirements for community banks with assets of less than $1 billion.

The Privacy Notice Modernization Act (S. 423), introduced by Senators Jerry Moran and Heidi Heitkamp, would eliminate annual privacy notice mailings when an institution has not changed its privacy policies. These notices are costly, redundant, and a source of confusion to many customers.

This is just a sampling of the legislation before this committee that would provide meaningful regulatory relief for community banks, help stave off further industry consolidation, and ultimate benefit consumers, particularly in rural communities such as the ones that I serve.

I thank you again for the opportunity to testify today and I hope that my comments are beneficial to the work of the subcommittee.

I am happy to answer any questions you may have.