

AMERISERV FINANCIAL INC /PA/

Form 10-K

March 08, 2016

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-K

(MARK ONE)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2015**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO**

COMMISSION FILE NUMBER 0-11204

AMERISERV FINANCIAL, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA
(State or other jurisdiction of
incorporation or organization)

25-1424278
(I.R.S. Employer
Identification No.)

MAIN & FRANKLIN STREETS,
P.O. BOX 430, JOHNSTOWN,
PENNSYLVANIA
(Address of principal executive offices)

15907-0430

(Zip Code)

Registrant's telephone number, including area code (814) 533-5300

Securities registered pursuant to Section 12(b) of the Act:

Title Of Each Class

Name Of Each Exchange On Which Registered

Common Stock, Par Value \$0.01 Per Share
8.45% Beneficial Unsecured Securities, Series A
(AmeriServ Financial Capital Trust I)

The NASDAQ Stock Market LLC

The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
 Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, accelerated filer, non-accelerated filer or a smaller reporting company. See definition of "accelerated filer, large accelerated filer and smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked prices of such common equity, as of the business day of the registrant's most recently completed second fiscal quarter. The aggregate market value was \$62,809,831 as of June 30, 2015.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date. There were 18,870,811 shares outstanding as of January 29, 2016.

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the proxy statement for the annual shareholders' meeting are incorporated by reference in Parts II and III.

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PART I

ITEM 1. BUSINESS

GENERAL

AmeriServ Financial, Inc. (the Company) is a bank holding company organized under the Pennsylvania Business Corporation Law. The Company became a holding company upon acquiring all of the outstanding shares of AmeriServ Financial Bank (the Bank) in January 1983. The Company's other wholly owned subsidiaries include AmeriServ Trust and Financial Services Company (the Trust Company), formed in October 1992, and AmeriServ Life Insurance Company (AmeriServ Life), formed in October 1987. When used in this report, the Company may refer to AmeriServ Financial, Inc. individually or AmeriServ Financial, Inc. and its direct and indirect subsidiaries.

The Company's principal activities consist of owning and operating its three wholly owned subsidiary entities. At December 31, 2015, the Company had, on a consolidated basis, total assets, deposits, and shareholders' equity of \$1.149 billion, \$903 million, and \$119 million, respectively. The Company and its subsidiaries derive substantially all of their income from banking and bank-related services. The Company functions primarily as a coordinating and servicing unit for its subsidiary entities in general management, accounting and taxes, loan review, auditing, investment accounting, marketing and risk management.

As a bank holding company, the Company is subject to supervision and regular examination by the Federal Reserve Bank of Philadelphia and the Pennsylvania Department of Banking and Securities (the PDB). The Company is also under the jurisdiction of the Securities and Exchange Commission (the SEC) for matters relating to registered offerings and sales of its securities under the Securities Act of 1933, as amended, and the disclosure and regulatory requirements of the Securities Exchange Act of 1934, as amended. The Company's common stock is listed on the NASDAQ Stock Market under the trading symbol ASRV, and the Company is subject to the NASDAQ rules applicable to listed companies.

AMERISERV FINANCIAL BANKING SUBSIDIARY

AMERISERV FINANCIAL BANK

The Bank is a state bank chartered under the Pennsylvania Banking Code of 1965, as amended (the Banking Code). Through 17 locations in Allegheny, Cambria, Centre, Somerset, and Westmoreland counties, Pennsylvania, the Bank conducts a general banking business. It is a full-service bank offering (i) retail banking services, such as demand, savings and time deposits, checking accounts, money market accounts, secured and unsecured consumer loans, mortgage loans, safe deposit boxes, holiday club accounts, money orders, and traveler's checks; and (ii) lending, depository and related financial services to commercial, industrial, financial, and governmental customers, such as commercial real estate mortgage loans (CRE), short and medium-term loans, revolving credit arrangements, lines of credit, inventory and accounts receivable financing, real estate-construction loans, business savings accounts, certificates of deposit, wire transfers, night depository, and lock box services. The Bank also operates 19 automated bank teller machines (ATMs) through its 24-hour banking network that is linked with NYCE, a regional ATM network, and CIRRUS, a national ATM network. West Chester Capital Advisors (WCCA), a SEC registered investment advisor, is also a subsidiary of the Bank. The Company also operates loan production offices (LPOs) in Monroeville and Altoona in Pennsylvania, Hagerstown in Maryland and Harrisonburg in Virginia.

We believe that the Bank's deposit base is such that loss of one depositor or a related group of depositors would not have a materially adverse effect on its business. The Bank's business is not seasonal, nor does it have any risks

attendant to foreign sources. A significant majority of the Bank's customer base is located within a 150 mile radius of Johnstown, Pennsylvania, the Bank's headquarters.

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The Bank is subject to supervision and regular examination by the Federal Reserve Bank of Philadelphia and the PDB. Various federal and state laws and regulations govern many aspects of its banking operations. The following is a summary of key data (dollars in thousands) and ratios of the Bank at December 31, 2015:

Headquarters	Johnstown, PA
Total Assets	\$ 1,108,994
Total Investment Securities	129,902
Total Loans and Loans Held for Sale (net of unearned income)	883,987
Total Deposits	903,494
Total Net Income	5,938
Asset Leverage Ratio	8.97 %
Return on Average Assets	0.55
Return on Average Equity	5.80
Total Full-time Equivalent Employees	247

RISK MANAGEMENT OVERVIEW:

Risk identification and management are essential elements for the successful management of the Company. In the normal course of business, the Company is subject to various types of risk, which includes credit, interest rate and market, liquidity, operational, legal/compliance, strategic/reputational and security risk. The Company controls and monitors these risks with policies, procedures, and various levels of oversight from the Company's Board of Directors (the Board) and management. The Company has both a Management Enterprise Risk Committee and a Board Enterprise Risk Committee to help manage and monitor the Company's risk position.

Interest rate risk is the sensitivity of net interest income and the market value of financial instruments to the magnitude, direction, and frequency of changes in interest rates. Interest rate risk results from various repricing frequencies and the maturity structure of assets and liabilities. The Company uses its asset liability management policy to control and manage interest rate risk.

Liquidity risk represents the inability to generate cash or otherwise obtain funds at reasonable rates to satisfy commitments to borrowers, as well as the obligations to depositors, debtholders and the funding of operating costs. The Company uses its asset liability management policy and contingency funding plan to control and manage liquidity risk.

Credit risk represents the possibility that a customer may not perform in accordance with contractual terms resulting in an economic loss to the organization. Credit risk results from extending credit to customers, purchasing securities, and entering into certain off-balance sheet loan funding commitments. The Company's primary credit risk occurs in the loan portfolio. The Company uses its credit policy and disciplined approach to evaluating the adequacy of the allowance for loan losses (the ALL) to control and manage credit risk. The Company's investment policy and hedging policy limit the amount of credit risk that may be assumed in the investment portfolio and through hedging activities.

The following summarizes and describes the Company's various loan categories and the underwriting standards applied to each:

Commercial Loans

This category includes credit extensions to commercial and industrial borrowers. Business assets, including accounts receivable, inventory and/or equipment, typically secure these credits. In appropriate instances, extensions of credit in this category are subject to collateral advance formulas. Balance sheet strength and profitability are considered when

analyzing these credits, with special attention given to historical, current and prospective sources of cash flow, and the ability of the customer to sustain cash flow at acceptable levels. The Bank's policy permits flexibility in determining acceptable debt service coverage ratios, with a minimum level of 1.1 to 1x desired. Personal guarantees are frequently required; however, as the financial strength of the borrower increases, the Bank's ability to obtain personal guarantees decreases. In addition to economic risk, this category is impacted by the strength of the borrower's management, industry risk and portfolio concentration risk each of which are also monitored and considered during the underwriting process.

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Commercial Loans Secured by Real Estate

This category includes various types of loans, including acquisition and construction of investment property, owner-occupied property and operating property. Maximum term, minimum cash flow coverage, leasing requirements, maximum amortization and maximum loan to value ratios are controlled by the Bank's credit policy and follow industry guidelines and norms, and regulatory limitations. Personal guarantees are normally required during the construction phase on construction credits and are frequently obtained on mid to smaller CRE loans. In addition to economic risk, this category is subject to geographic and portfolio concentration risk, each of which are monitored and considered in underwriting.

Residential Real Estate Mortgages

This category includes mortgages that are secured by residential property. Underwriting of loans within this category is pursuant to Freddie Mac/Fannie Mae underwriting guidelines, with the exception of Community Reinvestment Act (CRA) loans, which have more liberal standards. The major risk in this category is that a significant downward economic trend would increase unemployment and cause payment default. The Bank does not engage and has never engaged, in subprime residential mortgage lending.

Consumer Loans

This category includes consumer installment loans and revolving credit plans. Underwriting is pursuant to industry norms and guidelines. The major risk in this category is a significant economic downturn.

INVESTMENTS

The investment securities portfolio of the Company and its subsidiaries is managed primarily to provide ample liquidity to fund, for example, loan growth and secondarily for earnings in a manner that is consistent with proper bank asset/liability management and current banking practices. The objectives of portfolio management include consideration of proper liquidity levels, interest rate and market valuation sensitivity, and profitability. The investment portfolio of the Company and its subsidiaries are proactively managed in accordance with federal and state laws and regulations and in accordance with generally accepted accounting principles (GAAP).

The investment portfolio is primarily made up of AAA rated agency mortgage-backed securities and short maturity agency securities. Beginning in 2012, the Company began to add high quality corporate securities and select taxable municipal securities to the portfolio. Management strives to maintain a relatively short duration in the portfolio. All holdings must meet standards documented in its investment policy.

Investment securities classified as held to maturity are carried at amortized cost while investment securities classified as available for sale are reported at fair market value. The following table sets forth the cost basis and fair value of the Company's investment portfolio as of the periods indicated:

Investment securities available for sale at:

	AT DECEMBER 31,		
	2015	2014	2013
	(IN THOUSANDS)		
U.S. Agency	\$ 2,900	\$ 5,931	\$ 6,926

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Corporate bonds	18,541	15,497	11,992
U.S. Agency mortgage-backed securities	96,801	102,888	121,480
Total cost basis of investment securities available for sale	\$ 118,242	\$ 124,316	\$ 140,398
Total fair value of investment securities available for sale	\$ 119,467	\$ 127,110	\$ 141,978

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Investment securities held to maturity at:

	AT DECEMBER 31,		
	2015	2014	2013
	(IN THOUSANDS)		
Taxable municipal	\$ 5,592	\$ 3,364	\$ 1,521
U.S. Agency mortgage-backed securities	10,827	12,481	12,671
Corporate bonds and other securities	5,000	3,995	3,995
Total cost basis of investment securities held to maturity	\$ 21,419	\$ 19,840	\$ 18,187
Total fair value of investment securities held to maturity	\$ 21,533	\$ 20,213	\$ 17,788

DEPOSITS AND OTHER SOURCES OF FUNDS**Deposits**

The Bank has a stable core deposit base made up of traditional commercial bank products that exhibits little fluctuation, other than jumbo certificates of deposits (CDs), which demonstrate some seasonality. The Company also utilizes certain Trust Company specialty deposits related to the ERECT Fund as a funding source which serve as an alternative to wholesale borrowings and can exhibit some limited degree of volatility.

The following table sets forth the average balance of the Company's deposits and average rates paid thereon for the past three calendar years:

	AT DECEMBER 31,					
	2015		2014		2013	
	(IN THOUSANDS, EXCEPT PERCENTAGES)					
Demand:						
Non-interest bearing	\$ 171,175	%	\$ 155,365	%	\$ 158,169	%
Interest bearing	97,201	0.21	97,641	0.20	75,126	0.18
Savings	94,425	0.17	89,554	0.16	87,819	0.16
Money market	242,298	0.34	228,150	0.33	212,735	0.35
Other time	287,783	1.24	300,915	1.26	312,741	1.33
Total deposits	\$ 892,882	0.66 %	\$ 871,625	0.68 %	\$ 846,590	0.75 %

Loans

The loan portfolio of the Company consisted of the following:

	AT DECEMBER 31,				
	2015	2014	2013	2012	2011
	(IN THOUSANDS)				
Commercial	\$ 181,115	\$ 139,158	\$ 120,120	\$ 102,864	\$ 83,124
Commercial loans secured by real estate ⁽¹⁾	422,145	410,851	412,254	383,934	350,224
Real estate-mortgage ⁽¹⁾	257,937	258,616	235,689	217,584	212,669
Consumer	20,344	19,009	15,864	17,420	18,172
Total loans	881,541	827,634	783,927	721,802	664,189
Less: Unearned income	557	554	581	637	452

Total loans, net of unearned income **\$880,984** \$827,080 \$783,346 \$721,165 \$663,737

(1) For each of the periods presented beginning with December 31, 2015, real estate-construction loans constituted 3.0%, 3.5%, 3.0%, 2.0% and 1.9% of the Company's total loans, net of unearned income, respectively.

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The residential lending department of the Bank continues to originate one-to-four family mortgage loans for customers, the majority of which are sold to outside investors in the secondary market and some of which are retained for the Bank's portfolio. Mortgages sold on the secondary market are sold to investors on a flow basis; mortgages are priced and delivered on a best efforts pricing basis, with servicing released to the investor. Fannie Mae/Freddie Mac guidelines are used in underwriting all mortgages with the exception of a limited amount of CRA loans. Mortgages with longer terms, such as 20-year, 30-year, FHA, and VA loans, are usually sold. The remaining production of the department includes construction, adjustable rate mortgages, quality non-salable loans, and bi-weekly mortgages.

These loans are usually kept in the Bank's portfolio. New portfolio production is predominately adjustable rate mortgages.

Non-performing Assets

The following table presents information concerning non-performing assets:

	AT DECEMBER 31,				
	2015	2014	2013	2012	2011
	(IN THOUSANDS, EXCEPT PERCENTAGES)				
Non-accrual loans:					
Commercial	\$4,260	\$	\$	\$	\$
Commercial loans secured by real estate	18	778	1,632	4,623	3,870
Real estate-mortgage	1,788	1,417	1,239	1,191	1,205
Total	6,066	2,195	2,871	5,814	5,075
Other real estate owned:					
Commercial loans secured by real estate		384	344	1,101	20
Real estate-mortgage	75	128	673	127	104
Total	75	512	1,017	1,228	124
Total restructured loans not in non-accrual (TDR)	156	210	221	182	
Total non-performing assets including TDR	\$6,297	\$2,917	\$4,109	\$7,224	\$5,199
Total non-performing assets as a percent of loans, net of unearned income, and other real estate owned	0.71 %	0.35 %	0.52 %	1.00 %	0.78 %

The Company is unaware of any additional loans which are required to either be charged-off or added to the non-performing asset totals disclosed above. Other real estate owned (OREO) is measured at fair value based on appraisals, less cost to sell at the date of foreclosure. The Company had no loans past due 90 days or more, still accruing, for the periods presented.

The following table sets forth, for the periods indicated, (1) the gross interest income that would have been recorded if non-accrual loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination if held for part of the period, (2) the amount of interest income actually recorded on such loans, and (3) the net reduction in interest income attributable to such loans.

YEAR ENDED DECEMBER 31,				
2015	2014	2013	2012	2011

	(IN THOUSANDS)				
Interest income due in accordance with original terms	\$94	\$ 136	\$ 178	\$ 231	\$ 376
Interest income recorded					(167)
Net reduction in interest income	\$94	\$ 136	\$ 178	\$ 231	\$ 209

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AMERISERV FINANCIAL NON-BANKING SUBSIDIARIES

AMERISERV TRUST AND FINANCIAL SERVICES COMPANY

AmeriServ Trust and Financial Services Company is a trust company organized under Pennsylvania law in October 1992. Its staff of approximately 48 professionals administers assets valued at approximately \$2.0 billion that are not recognized on the Company's balance sheet at December 31, 2015. The Trust Company focuses on wealth management. Wealth management includes personal trust products and services such as personal portfolio investment management, estate planning and administration, custodial services and pre-need trusts. Also, institutional trust products and services such as 401(k) plans, defined benefit and defined contribution employee benefit plans, and individual retirement accounts are included in this segment. This segment also includes financial services which include the sale of mutual funds, annuities, and insurance products. The wealth management business also includes the union collective investment funds, namely the ERECT and BUILD funds which are designed to use union pension dollars in construction projects that utilize union labor. The BUILD fund is in the process of liquidation. At December 31, 2015, the Trust Company had total assets of \$4.9 million and total stockholder's equity of \$4.6 million. In 2015, the Trust Company contributed earnings to the Company as its gross revenue amounted to \$8.5 million and the net income contribution was \$1.3 million. The Trust Company is subject to regulation and supervision by the Federal Reserve Bank of Philadelphia and the PDB.

AMERISERV LIFE

AmeriServ Life is a captive insurance company organized under the laws of the State of Arizona. AmeriServ Life engages in underwriting as reinsurer of credit life and disability insurance within the Company's market area. Operations of AmeriServ Life are conducted in each office of the Company's banking subsidiary. AmeriServ Life is subject to supervision and regulation by the Arizona Department of Insurance, the Pennsylvania Insurance Department, and the Board of Governors of the Federal Reserve System (the Federal Reserve). At December 31, 2015, AmeriServ Life had total assets of \$389,000.

MONETARY POLICIES

Commercial banks are affected by policies of various regulatory authorities including the Federal Reserve. An important function of the Federal Reserve is to regulate the national supply of bank credit. Among the instruments of monetary policy used by the Federal Reserve are: open market operations in U.S. Government securities, changes in the federal funds rate and discount rate on member bank borrowings, and changes in reserve requirements on bank deposits. These means are used in varying combinations to influence overall growth of bank loans, investments, and deposits, and may also affect interest rate charges on loans or interest paid for deposits. The monetary policies of the Federal Reserve have had, and will continue to have, a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

COMPETITION

Our subsidiaries face strong competition from other commercial banks, savings banks, credit unions, savings and loan associations, and other financial or investment service institutions for business in the communities they serve. Several of these institutions are affiliated with major banking and financial institutions which are substantially larger and have greater financial resources than the Bank and the Trust Company. As the financial services industry continues to consolidate, the scope of potential competition affecting our subsidiaries will also increase. Brokerage houses, consumer finance companies, insurance companies, and pension trusts are important competitors for various types of financial services. In addition, personal and corporate trust investment counseling services are offered by insurance companies, other firms, and individuals.

MARKET AREA & ECONOMY

Johnstown, Pennsylvania, where the Company is headquartered, continues to have a cost of living that is lower than the national average. Johnstown is home to The University of Pittsburgh at Johnstown, Pennsylvania Highlands Community College and Cambria-Rowe Business College. The high-tech defense industry is now the main non-health care staple of the Johnstown economy, with the region fulfilling many Federal government contracts, punctuated by one of the premier defense trade shows in the U.S., the annual

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Showcase For Commerce. The city also hosts annual events such as the Flood City Music Festival and the Thunder in the Valley Motorcycle Rally, which draw several thousand visitors. The Johnstown, PA MSA unemployment rate improved from a 6.9% average in 2014 to a 6.5% average in 2015.

Economic conditions are stronger in the State College market and have demonstrated the same improvement experienced in the national economy. The community is a college town, dominated economically and demographically by the presence of the University Park campus of the Pennsylvania State University. Happy Valley is another often-used term to refer to the State College area, including the borough and the townships of College, Harris, Patton, and Ferguson. The unemployment rate for State College MSA improved from a 4.2% average in 2014 to a 3.8% average in 2015 and remains the one of the lowest of all regions in the Commonwealth. A large percentage of the population in State College falls into the 18 to 34 year old age group, while potential customers in the Cambria/Somerset markets tend to be over 50 years of age.

The Company also has loan production offices in Monroeville in Allegheny county, Altoona in Blair county, Pennsylvania, Hagerstown in Washington county, Maryland and Harrisonburg in Rockingham county, Virginia. Monroeville in Allegheny county, Pennsylvania is located 15 miles east of the city of Pittsburgh. While the city is historically known for its steel industry, today its economy is largely based on healthcare, education, technology and financial services. The city of Pittsburgh is home to many colleges, universities and research facilities, the most well-known of which are Carnegie Mellon University, Duquesne University and the University of Pittsburgh. Pittsburgh is rich in art and culture. Pittsburgh museums and cultural sites include the Andy Warhol Museum, the Carnegie Museum of Art, the Frick Art & Historical Center, and Pittsburgh Center for the Arts among numerous others. Pittsburgh is also the home of the Pirates, Steelers and Penguins. The unemployment rate for Pittsburgh MSA improved from a 5.6% average in 2014 to a 5.2% average in 2015.

Altoona is the business center of Blair county, Pennsylvania with a strong retail, government and manufacturing base. The top field of employment in Altoona and the metro area is healthcare. Its location along I-99 draws from a large trade area over a wide geographic area that extends to State College and Johnstown. It serves as the headquarters for Sheetz Corporation which ranks on Forbes list of the top privately owned companies. In addition to being located adjacent to I-99 and a major highway system, Altoona also has easy access to rail and air transportation. The unemployment rate in the Altoona MSA decreased from a 5.6% average in 2014 to a 5.1% average in 2015.

Hagerstown and Washington county, Maryland offers a rare combination of business advantages providing a major crossroads location that is convenient to the entire East Coast at the intersection of I-81 and I-70. It has a workforce of over 400,000 with strengths in manufacturing and technology. It also offers an affordable cost of doing business and living within an hour of the Washington, D.C./Baltimore regions. There are also plenty of facilities and land slated for industrial/commercial development. Hagerstown has become a choice location for manufacturers, financial services, and distribution companies. The Hagerstown, MD-Martinsburg, WV MSA unemployment rate improved from a 6.0% average in 2014 to a 5.5% average in 2015.

Harrisonburg is located on I-81, providing convenient access via interstate to Northern Virginia/Washington D.C., and Richmond, in addition to points north and south along I-81. The Shenandoah Valley Regional Airport provides the same amenities as larger airports and is located 20 minutes from Harrisonburg via I-81. It has a diverse and vibrant economy, with a good blend of business interests and employment opportunities. Rockingham county is one of the top agricultural producers in Virginia. Harrisonburg is home to James Madison University and Eastern Mennonite University. Continuing growth in education, health services and technology, plus a diverse mix of manufacturing, agriculture, retail, service and tourism helps Harrisonburg/Rockingham county prosper. The City of Harrisonburg Economic Development Department has established Harrisonburg Technology Park and the Harrison Downtown Technology Zone to attract technology based firms. The Harrisonburg MSA unemployment rate improved from a

5.2% average in 2014 to a 4.6% average in 2015.

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EMPLOYEES

The Company employed 341 people as of December 31, 2015 in full- and part-time positions. Approximately 162 non-supervisory employees of the Company are represented by the United Steelworkers, AFL-CIO-CLC, Local Union 2635-06. The Company is under a four year labor contract with the United Steelworkers Local that will expire on October 15, 2017. The contract calls for annual wage increases of 3.0%. Additionally, effective January 1, 2014, the Company implemented a soft freeze of its defined benefit pension plan for union employees. A soft freeze means that all existing union employees as of December 31, 2013 currently participating will remain in the defined benefit pension plan but any new union employees hired after January 1, 2014 will no longer be part of the defined benefit plan but instead will be offered retirement benefits under an enhanced 401(k) program. The Company has not experienced a work stoppage since 1979. The Company is one of an estimated ten union-represented banks nationwide.

INDUSTRY REGULATION

The banking and trust industry, and the operation of bank holding companies, is highly regulated by federal and state law, and by numerous regulations adopted by the federal banking agencies and state banking agencies. Bank regulation affects all aspects of conducting business as a bank, including such major items as minimum capital requirements, limits on types and amounts of investments, loans and other assets, as well as borrowings and other liabilities, and numerous restrictions or requirements on the loan terms and other products made available to customers, particularly consumers. Federal deposit insurance from the Federal Deposit Insurance Corporation (the FDIC) is required for all banks in the United States, and maintaining FDIC insurance requires observation of the various rules of the FDIC, as well as payment of deposit premiums. New branches, or acquisitions or mergers, are required to be pre-approved by the responsible agency, which in the case of the Company and the Bank is the Federal Reserve and the PDB. The Bank provides detailed financial information to its regulators, including a quarterly call report that is filed pursuant to detailed prescribed instructions to ensure that all U.S. banks report the same way. The U.S. banking laws and regulations are frequently updated and amended, especially in response to crises in the financial industry, such as the global financial crisis of 2008, which resulted in the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted in 2010 (the Dodd-Frank Act), a statute affecting many facets of the financial industry.

While it is impractical to discuss all laws and regulations that regularly affect the business of the Company and its subsidiaries, set forth below is an overview of some of the major provisions and statutes that apply.

CAPITAL REQUIREMENTS

One of the most significant regulatory requirements for banking institutions is minimal capital, imposed as a ratio of capital to assets. The Federal Deposit Insurance Act, as amended (the FDIA), identifies five capital categories for insured depository institutions: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. It requires U.S. federal bank regulatory agencies to implement systems for prompt corrective action for insured depository institutions that do not meet minimum capital requirements based on these categories. The FDICIA imposes progressively more restrictive constraints on operations, management and capital distributions, depending on the category in which an institution is classified. Unless a bank is well capitalized, it is subject to restrictions on its ability to utilize brokered deposits and on other aspects of its operations. Generally, a bank is prohibited from paying any dividend or making any capital distribution or paying any management fee to its holding company if the bank would thereafter be undercapitalized.

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As of December 31, 2015, the Company believes that its bank subsidiary was well capitalized, based on the prompt corrective action guidelines described above. As discussed below, however, the capital requirements for all banks are being increased under the Dodd-Frank Act. Specifically, on July 2, 2013, the Federal Reserve approved final rules that substantially amend the regulatory risk-based capital rules applicable to the Company and the Bank. The final rules implement the Basel III regulatory capital reforms, as well as certain changes required by the Dodd-Frank Act. The July 2013 final rules generally implement higher minimum capital requirements, add a new common equity tier 1 capital requirement, and establish criteria that instruments must meet to be considered common equity tier 1 capital, additional tier 1 capital or tier 2 capital. The new capital to risk-adjusted assets requirements (which includes the impact of the capital conservation buffer effective January 1, 2016) are as follows:

	Minimum Capital		Well Capitalized
	Effective January 1, 2015	2016	
Common equity tier 1 capital ratio	4.5 %	5.125 %	6.5 %
Tier 1 capital ratio	6.0 %	6.625 %	8.0 %
Total capital ratio	8.0 %	8.625 %	10.0 %

Under the new rules, in order to avoid limitations on capital distributions (including dividend payments and certain discretionary bonus payments to executive officers), a banking organization must hold a capital conservation buffer comprised of common equity tier 1 capital above its minimum risk-based capital requirements in an amount greater than 2.5% of total risk-weighted assets. The capital conservation buffer, which is composed of common equity tier 1 capital, began on January 1, 2016 at the 0.625% level and will be phased in over a three year period (increasing by that amount on each January 1, until it reaches 2.5% on January 1, 2019). Implementation of the deductions and other adjustments to common equity tier 1 capital began on January 1, 2015 and will be phased-in over a three-year period (beginning at 40% on January 1, 2015, 60% on January 1, 2016 and an additional 20% per year thereafter). The Company is continuing to review the impact of these new rules and currently expects that its capital position will be more than adequate to meet the revised regulatory capital requirements.

DIVIDEND RESTRICTIONS

The primary source of cash to pay dividends, if any, to the Company's shareholders and to meet the Company's obligations is dividends paid to the Company by the Bank and the Trust Company. Dividend payments by the Bank to the Company are subject to the laws of the Commonwealth of Pennsylvania, the Banking Code, the FDIA and the regulation of the PDB and of the Federal Reserve. Under the Banking Act and the FDIA, a bank may not pay any dividends if, after paying such dividends, it would be undercapitalized under applicable capital requirements. In addition to these explicit limitations, the federal regulatory agencies are authorized to prohibit a banking subsidiary or bank holding company from engaging in unsafe or unsound banking practices. Depending upon the circumstances, the agencies could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

It is the policy of the Federal Reserve that bank holding companies should pay cash dividends on common stock only out of income available from the immediately preceding year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividend that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiary. A bank holding company may not pay dividends when it is insolvent.

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The Company resumed paying quarterly cash dividends to common shareholders in 2013. For more information regarding quarterly cash dividends, see Part II, Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities below.

SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 is not a banking law, but contains important requirements for public companies in the area of financial disclosure and corporate governance. In accordance with Section 302(a) of the Sarbanes-Oxley Act, written certifications by the Company's principal executive officer and principal financial officer are required. These certifications attest, among other things, that the Company's quarterly and annual reports filed with the SEC do not contain any untrue statement of a material fact. In response to the Sarbanes-Oxley Act of 2002, the Company adopted a series of procedures to further strengthen its corporate governance practices. The Company also requires signed certifications from managers who are responsible for internal controls throughout the Company as to the integrity of the information they prepare. These procedures supplement the Company's Code of Conduct Policy and other procedures that were previously in place. In 2005, the Company implemented and has since maintained a program designed to comply with Section 404 of the Sarbanes-Oxley Act. This program included the identification of key processes and accounts, documentation of the design of control effectiveness over process and entity level controls, and testing of the effectiveness of key controls.

PRIVACY PROVISIONS

Federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about customers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to non-affiliated third parties. The privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. The Company believes it is in compliance with the various provisions.

USA PATRIOT ACT

A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA Patriot Act substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States. The United States Treasury Department has issued and, in some cases, proposed a number of regulations that apply various requirements of the USA Patriot Act to financial institutions. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Failure of a financial institution to maintain and implement adequate programs to combat money launde