Testimony of

H. Charles Maddy, III

President and CEO, Summit Financial Group

Before the

Committee on Financial Services

United States House of Representatives

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Chairman Bachus, Ranking Member Frank, Congresswoman Capito, and members of the Committee, my name is Charlie Maddy, President and CEO, Summit Financial Group. My bank, Summit Community Bank is headquartered in Moorefield, West Virginia, and serves communities located in the south-central and eastern panhandle regions of West Virginia as well as in the Shenandoah Valley and northern regions of Virginia. I am pleased to be here today on the subject of how the financial crisis and the Dodd-Frank financial reform bill affects community banks like mine.

At my bank, as is true of my community bank colleagues in West Virginia and around the country, we are intensely focused on building and maintaining long-term relationships with our customers. We have to have this long-term view because we plan to be here for a very long time, and that requires us to provide the financial services that will keep our communities strong and growing. The success of Summit Community Bank is inextricably linked to the success of the communities we serve, and we are very proud of our relationships with them. They are, after all, our friends and neighbors.

Let me just give you a couple of examples of why our bank matters to our communities:

- My bank presently has more than half a billion dollars in loans outstanding to West Virginia and Virginia small businesses located within these same communities.
- We annually contribute more than a quarter million dollars to schools, charitable organizations, and civic and community organizations throughout our service area.
- Over the years, our employees have contributed thousands of hours of community service in support of local non-profit organizations and charities.

As a community bank, I am very concerned with all the new laws and regulations that my bank will have to contend with. I can tell you that the impact will certainly be enormous in terms of staff time, compliance obligations, reduced income, and most importantly, fewer resources that I will have to meet the needs of the communities in West Virginia that I serve. It is particularly frustrating to me, and I'm sure most other community bankers, that we end up being punished for the actions taken by others. We never made an exotic mortgage loan, changed our underwriting standards, or took excessive risks. Yet, in the last two years, community banks in my state and around the country have been subject to intense regulatory scrutiny, calls for more capital (at a time when new capital is hard to find), and pressure to add compliance staff to deal with all new regulations. How can I be out in my community, helping individuals improve their quality of life, or helping small businesses grow if all I end up doing is dealing with the aftermath of problems that I did not create?

The pressures come from both the regulators (who are naturally reacting, but I'd say over-reacting, to the economic downturn) and the new rules that are just beginning to be felt from the Dodd-Frank Act.

Let me give you a bit of perspective on the regulatory side first.

Prior to the current economic crisis, bankers were well aware of where their institutions stood in terms of capital adequacy. Capital guidelines were well established, and bankers could plan for growth (i.e., make new loans) without concern that they would be criticized by regulators for having insufficient capital. Over the past couple years though, I have heard from many bankers who have complained that whatever capital their institutions presently have, it's not enough in the eyes of their regulator. Well managed and profitable community banks with capital-to-asset ratios at or above that of their peers, and without significant asset quality problems, are being told their capital is inadequate and to increase it. Given this pressure to raise capital-to-assets ratios, you can understand why some of these same bankers may not be anxious to grow their balance sheets and aggressively seek new lending opportunities.

I and other community bankers have also observed another trend: certain bank regulations which were promulgated as "guidance" before the financial crisis are now being enforced as strict regulatory "limits." An example of this is in regards to the Interagency Guidance on *Concentrations in Commercial Real Estate Lending* (December 12, 2006). In its introduction, this Guidance reasonably states that it "does not establish specific CRE [commercial real estate] lending limits; rather, it promotes sound risk management practices and appropriate levels of capital that will enable

institutions to continue to pursue CRE lending in a safe and sound manner". However, the supervisory criteria contained in the Guidance is intended only for use by "regulators" to "identify" those institutions which "may" have CRE concentration risks; but instead it is now being interpreted and applied by the regulators as firm CRE lending limits. Prior to 2010, my bank operated with CRE levels in excess of the Guidance's criteria -- and without regulatory criticism. But only recently, our regulator strongly "encouraged" my bank to adopt CRE lending policy limits which essentially mirror the Guidance's supervisory criteria – and in so doing it will reduce our ability to make new commercial real estate loans by well over $100 million.

Another regulatory issue which community bankers are experiencing during this economic downturn is that often the conclusions and recommendations of local field examiners – who annually visit our banks to conduct extensive examinations lasting numerous weeks – are being overruled by their superiors at the regional or even national level. During a recent examination of my bank, I witnessed this first hand as the conclusions we were given by our senior field examiner at the exam-exit conference in regards to my bank's liquidity and interest rate sensitivity were markedly different from that which were ultimately included in the final report of examination. Upon my questioning of the field examiners about the necessity for the changes in the report, we were told that they had been dictated by the regional office, ostensibly due to their concern that certain of our financial ratios were outside a range which they had established. Certainly, you can understand my and my fellow bankers' exasperation when the observations and conclusions by the regulators who know our banks best are overturned by those who we have never even met.

Unfortunately, in my view, banking policy has become too D.C.-centric. Changes are being made without any formal process, and new standards are being applied without banks having a clear understanding of what they are. Banks should at least be told what ratios the examiners are using for standards. Moreover, often these changes are applied differently from bank to bank.

In addition, the regulatory higher-ups seem to have taken away much of the discretion from the regulators which are closest to the banks. As a result, field examiners and regional offices are not free to design remedial action plans which address the specific needs and issues of a particular financial institution. The regulators in Washington seem intent on twisting the screws tighter and tighter, rather than whether or not the terms of a particular remedial action are, in fact, appropriate for the bank to which it is directed.

So why is this? Well, I believe the answer may start with the Congress. Invariably, at the beginning of an economic downturn, the regulatory policy-makers are called before Congress to

explain why they are not using ***all*** sanctions at their disposal – in other words, why are the bank regulators not being "tough enough"? For instance, if a bank fails without a formal administrative action in place, there will be criticism leveled upon the regulator responsible. Further, in the case of every single bank failure, the FDIC's Office of Inspector General will perform a review of the causes for the failure, and such reports will likely criticize the regulator for being slow to act. Such institutionalized feedback serves only to further the pre-existing regulatory tendency for overkill. After all, regulators do not lose their jobs for being too tough.

The time to be "tough" is before an economic downturn when it can help head off problems. But when employed after the crisis has started, it accelerates the problems and can drive viable institutions over the cliff. It's like adding fertilizer on your lawn in the heat of the summer; it's only going kill the grass, not help it. At the current stage in the economic cycle, it is too late to simply be tough. There needs to be more cooperation amongst all parties involved to work towards the greater good, which in my opinion promotes economic recovery.

Regarding the Dodd-Frank Act, it will have an enormous and negative impact on my bank. Already there are over 1,000 pages of new proposed rules and there will be many thousands more, many of which will come from the Bureau of Consumer Financial Protection (Bureau). Summit Community Bank is larger than many banks in West Virginia, and we have about 200 people serving our customers. ***We have already added one new full time member to our compliance staff. This may not be enough.*** The typical bank in West Virginia has only about 50 employees. I know how demanding the crush of paperwork is for my staff, and I can't imagine the pressure that most community banks face with far fewer employees.

One of the claims was that small banks would not be affected by the new Bureau. But all banks will be subject to any new rules, even though community banks like mine will not be directly supervised by the Bureau. The FDIC (my bank's federal regulator) will examine for compliance at least as aggressively as the Bureau would do. In fact, the FDIC has created a whole new division just to implement the rules promulgated by the new Bureau. Once again, my bank's philosophy has always been to treat our customers right and do whatever we can to make sure that they understand the terms of the loans they are taking on and their obligations to us. We will continue to do this, but now there will be many new hurdles that we'll have to jump that will inevitably add costs, time, and hassle for my customers.

Another so-called "carve-out" under Dodd-Frank for community banks that will not work in practice is the exemption from interchange price setting. Under the act, the Fed must mandate prices for interchange (which is the fee merchants have paid when customers use debit cards to buy goods and services) for banks over $10 billion in assets. The Fed has proposed a rate that would reduce interchange revenue by more than 70 percent. Smaller banks can theoretically charge a higher interchange fee, but the economic incentives are so large that smaller banks like mine will almost certainly be forced to adopt the same price level or risk losing business to the largest banks. Market share will always flow to the lowest priced product, even if those lower prices are mandated only for some. The result for small banks is either a loss of market share, loss of revenue that supports free checking and other valuable services, or both.

Revenue from interchange is very important to my bank as it helps to offset some of the costs of providing checking account services to my customers. If I lose even a portion of interchange revenue, I have to rethink how I can cover my costs, whether it's in new debit card fees, or a reduction in staff, or in how I price loans. I cannot offer financial services if I can't cover the costs of doing so.

What seems to be missed here is the profile of the customer who will be most unjustly affected by the change in the way we are being forced to cover our costs and generate our revenues. Here in West Virginia, we have many hard working men and women who make just enough to "make ends meet". But they are some of the most honest and ethical individuals you will ever meet. They balance their checkbook to the penny and rarely, if ever overdraft. So, they currently are able to get most of their basic banking services free of charge. Yes, the revenues of others support these free services, but I can't think of a group that deserves it more. If trends continue, free checking and similar services are likely to disappear for everyone. We think this is bad public policy.

Summit Community Bank will survive these changes. But it is important to understand that our bank, indeed, any small business, can only bear so much. Higher costs, restrictions on sources of income, limits on new sources of capital, regulatory pressure to limit or reduce lending in certain sectors, all make it harder to meet the needs of our communities.

I have spoken to many bankers throughout the country who describe themselves as simply miserable. Some have already sold their banks; others plan to do so once the economic environment improves. As I mentioned before, most small banks do not have the resources to manage the flood of new rules. In fact, I have heard from bankers in two separate forums say that

regulators have told them that banks under $500 million in assets should consider merging as they are too small to survive. That translates to 90 percent of all banks headquartered in West Virginia. The Dodd-Frank Act was intended to stop the problem of too-big-to-fail, yet now we have even bigger institutions; ironically, the result may be that some banks will be too-small-to-survive the onslaught of the Dodd-Frank rules.

Mr. Chairman, I truly appreciate the fact that this committee is looking at the impact of recent regulatory and legislative changes that are affecting small banks like mine. There is so much more to tell. I'm hopeful that through these types of hearings, there is some recognition of the importance that community banks play throughout our country, the extra burden they must now bear, and the relief that is needed to restore the balance so that we can continue to make loans and meet the financial needs in our community.

Thank you and I'd be happy to answer any questions you might have.

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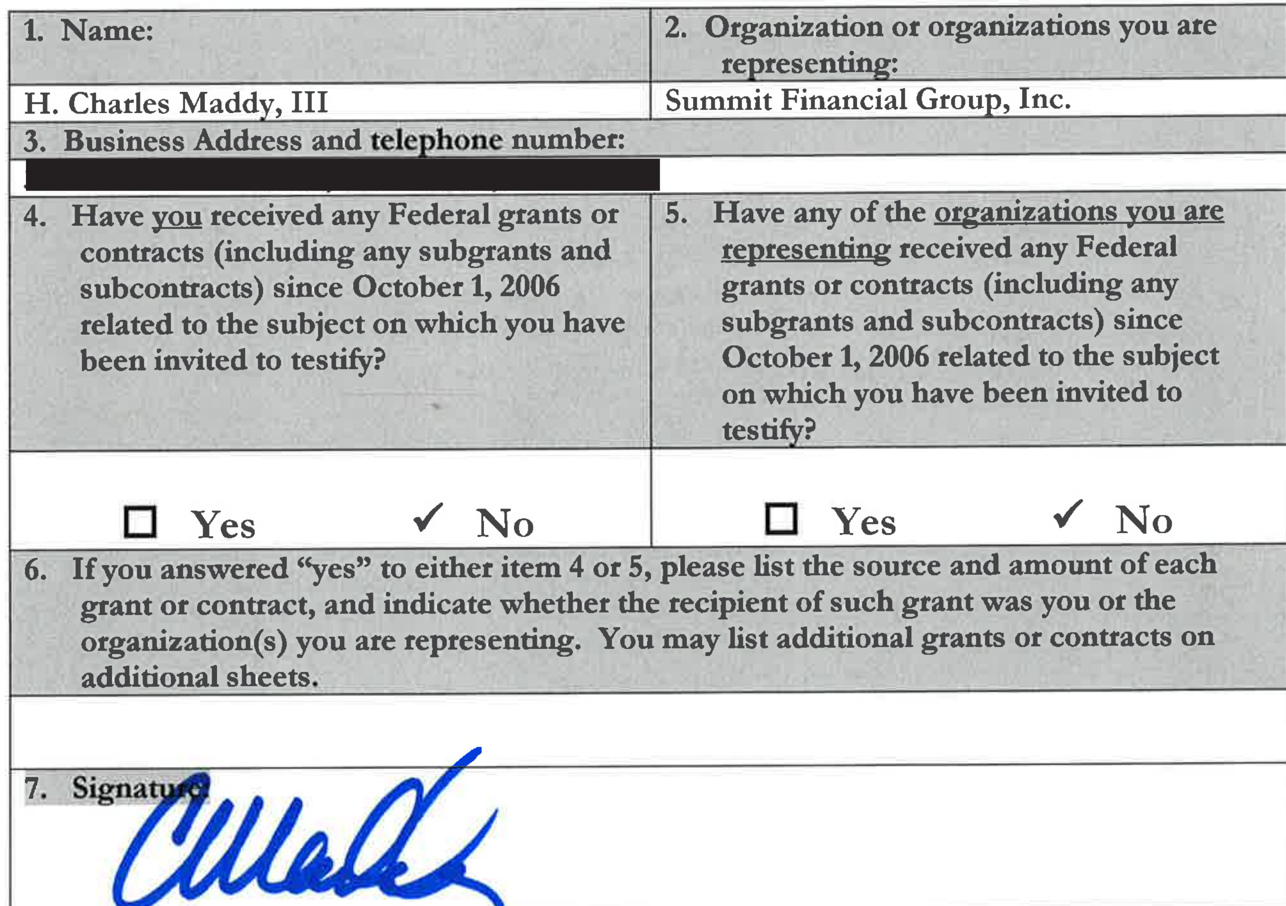
Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.



1. Name:	2. Organization or organizations you are representing:
H. Charles Maddy, III	Summit Financial Group, Inc.
3. Business Address and telephone number:	
[redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2006 related to the subject on which you have been invited to testify?
☐ Yes ✓ No	☐ Yes ✓ No
6. If you answered "yes" to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.