



## Too Small To Comply — More Important than TBTF?\*

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While some trade associations representing small banks would like to see drastic changes in the structure and operations of the larger banks, and argue that large banks receive an unfair advantage on funding because of a conception that they are too big to fail, there is another issue that would seem to me to be an even more pressing issue for small lenders, particularly small mortgage lenders.

Regulatory compliance has become very burdensome. From difficult capital rules, new examination emphasis, and an increasing variety of rules, such as those promulgated under the Dodd-Frank Act, the small banks are being pressured from all sides to establish expertise not currently employed by them to deal with these new requirements.

For example, the rules that have been promulgated by the Consumer Financial Protection Bureau, pursuant to the dictates of the Dodd-Frank Act, plus those on securitization that the joint agency group will promulgate sometime this year, cover all aspects of mortgage lending. They are in great detail, and the explanations provided in the section by section analysis in the material that accompanies the final rules are intense and long (well over 3500 pages).

Yet, it is not just the length of the rules that creates the problem. To comply with almost any of them requires a team of lawyers, analysts, systems persons, persons trained to train staff, quality control positions, and persons designated to monitor updates that appear from time to time. These persons are not always readily available, and when available, are not inexpensive. Therefore, many of the smaller firms must rely on outside experts to assist them in complying with the rules; that can be particularly expensive.

Once operational, there then follows the question of remaining current

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as new interpretations are provided by the regulators or courts through any of a variety of means. Examiners will then arrive to review everything that has been done, and to expect answers in all of the new fields. There always exists the possibility that a consumer will feel that the rate it obtained was corrupted through the process, or there was a failure to appreciate the income restrictions of the borrower based on a plaintiff-driven analysis of the complex and ambiguous provisions in Appendix Q to the ATR rules, or an inexact notice of certain rights, etc.

And these are just the new rules. None of the old ones have gone away. If the small bank is in the mortgage business, it must also remain current with the changing rules of the GSEs, and perhaps even of FHA, if it is an FHA lender. Those business lines are generally allocated to specialists in the larger banks, but it is just part of what a banker with a staff of — say — 25 must do in the smaller banks.

That banker must do all of this while trying to actually make a profit at his or her bank. Competition no longer is just the bank across the street or in the next county — it's national. On-line banking has become a reality among small bank customers as well as among customers of larger banks, and the competitor can be whoever drafts an appealing website with a snappy logo and eye-catching motto.

Bankers can decide to drop a particular line of business if the compliance burden gets too extreme and expensive. But mortgages have always been a very good, conservative line of business, and small banks are hesitant to drop any line since competition for good customers is intense.

So, while it is probably satisfying to issue yet another press release about too big to fail, I would suspect that the real killer in the woods for small banks is the amount and complexity of regulations that are regularly and consistently promulgated, year after year. Each has a purpose that is in some way justifiable — taken together they are debilitating to small banks.

Joshua Seigel of SandCastles, an analyst of community banks, has said that he believes the community banking field is ripe for consolidation, and that perhaps as many as 4,000 of the 7,000 existing community banks are ripe for elimination.<sup>1</sup> The compliance burden is a key cost to which he points, but he also points out that the management of those banks has aged, and there are frequently no succession candidates. He does not place

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<sup>1</sup>Wealth Wire, February 28, 2013.

any funding advantage the largest banks might have as among the important reasons the smaller banks face elimination.

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