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Foreclosure orders punctuate regulatory burden to trickle down to community banks

By [Kevin Dobbs](#)

When U.S. regulators on April 13 officially called for an overhaul in the way lenders deal with struggling homeowners, they confined their [consent orders](#) to large financial companies that have been the targets of consumer complaints over sloppy mortgage processing and unfair foreclosure practices.

But executives at [FinPro Inc.](#), who have met with every major regulator in recent months to discuss how banks should brace for looming rules changes under the sweeping Dodd-Frank financial reform legislation, told SNL that the effect of the orders is bound to wind its way down to smaller banks, likely joining a string of rules intended to bolster service and risk management at big banks but that ultimately could overburden the nation's community banks.

"Like so many others, [community bankers] fear these rules will be pushed down on everybody," said Donald Musso, president & CEO of FinPro, the Liberty Corner, N.J.-based financial institutions advisory and consulting company.

Musso and Nicholas Ketcha Jr., executive managing director at FinPro, told SNL that in the wake of the financial crisis, bank examiners are loathe to see any bank fail on their watch. As such, they are often interpreting any call for tougher compliance, even if explicitly targeted at big banks, as a hard-and-fast rule that all banking companies must follow.

"What starts out as something for the larger banks all of a sudden comes up as a best practice for all," Ketcha said, noting that regulators have pushed for tougher capital requirements at big banks and, already, smaller banks across the country are trying to comply with examiners' demands to hold more capital than the official level designated for them.

Another case in point: The Durbin amendment to Dodd-Frank, which along with other new rules is to take effect in July. The Fed has called for capping at 12 cents per transaction the debit-card transaction fee that banks over \$10 billion in assets can charge — a steep cut from the 40 cents or more that banks currently charge. [Community banks](#) are supposed to be exempt, but bankers say the exception is meaningless, because market forces will compel smaller banks to lower prices in order to compete with larger players. This would not only cut into a source of cherished fee income but also cripple their ability to price for risk, several bankers have told SNL, ultimately forcing community banks to drop the service or at least curtail any investments in advancing technology on this front.

It is a prime example of the challenges that Dodd-Frank poses, Musso said.

"We're spending so much time on Dodd-Frank that we're not doing anything entrepreneurial in the business right now," he said. "Everyone is scared of what new regulation is going to come next."

The "vast majority" of bankers he speaks with, Musso added, "see themselves spending a lot of time and a lot of money on compliance, and they are not sure what, if any, benefit they can get from it."

The mortgage servicing issue amplifies community bankers' reason for concern, he said.

Among other steps, the Fed, the OCC and the OTS in their orders this week required big lenders such as [JPMorgan Chase & Co.](#), [Bank of America Corp.](#) and [Wells Fargo & Co.](#) to establish new compliance programs to ensure mortgage-servicing and foreclosure operations comply with supervisory guidance; to retain an independent firm to conduct comprehensive assessment of risks in servicing operations; and to hire an independent reviewer of residential foreclosure actions that were pending at any time from January 1, 2009, through Dec. 31, 2010, and to address errors or misrepresentations.

Jaret Seiberg, an MF Global policy analyst, said in a [report](#) that "this tracks closely to the type of changes" that many big banks "already have implemented or have been planning for several months to implement," and he suggested the orders were manageable for large lenders.

Musso agreed, and he said the big banks need to show that they have both good processes in place to handle massive mortgage volume and that they have well-trained staff and other resources in place to make sure they are "not taking short-cuts."

But for smaller banks that simply do not deal in mass volume, the loan-servicing orders would amount to a significant overstretch of regulation; yet, given the early history of financial reform, community bankers have reason to worry that such demands could eventually trickle down to them, he said.

"There's concern about a lot of overkill Musso said.

Said Ketcha, "Everybody's looking over their shoulder right now."