**BankThink How Dodd-Frank Makes M&A More Difficult**

**By**

* **Thomas P. Vartanian August 21 2013, 9:57am EDT**

In the 1970s and 1980s, a major hurdle for almost any bank merger was the extent to which it could have an adverse impact on competition in a county or metropolitan area under federal antitrust laws. Those days are long gone. With a wave of mergers and acquisitions inevitable, a new set of regulatory hurdles have evolved for large financial entities and community banks alike.

Similarly, investments by private equity and hedge funds continue, but they also face heightened regulatory scrutiny directed at their post-investment control of the target bank. The remedies in those cases include passivity commitments, anti-affiliation certifications and affiliated transaction limitations, all of which are negotiable based on the nature of the investment, the role of the investor and type of affiliation that is contemplated.

Based on the transactions completed in the last few years, let's examine the range of issues that may impede consolidations and how banks should prepare for and approach them.

At least one recent large bank acquisition has been delayed because of the acquiring bank's AML/BSA issues.

Lapses in monitoring AML/BSA compliance will derail any size transaction until substantial compliance is achieved with regard to: policies and procedures, auditing and monitoring functions, training and education, and maintaining a corporate record that reflects the implementation of these steps. Greater regulatory concerns arise when there is evidence of actual money laundering or overt or camouflaged dealings with OFAC-restricted countries.

Targets need to make sure that they are in compliance, and acquirers must conduct sufficient due diligence to make an independent determination as to whether the transaction can get regulatory approval.

**Troubled Asset Relief Program**

TARP securities held by the remaining 140 banks raise significant issues that must be addressed with Treasury and bank regulators. They include: the extent to which Treasury accepts a discount for the repayment of its TARP securities, or remains an investor in the combined entity; alternative security instruments that can be used; impacts on executive compensation; the relative financial treatment of legacy stockholders; and the role of new investors. Each agency has its public pronouncements, internal policies and practices in these areas that must be harmonized.

**Impact of New Mortgage and Consumer Protection Rules**

Dodd-Frank and its implementing regulations are beginning to impact the mortgage finance delivery, servicing and securitization markets. These new requirements, such as the ability-to-repay and qualified mortgage rules create a five-dimensional challenge for lenders who now find themselves positioned squarely between defaulting borrowers, the Consumer Financial Protection Bureau, bank safety and soundness requirements, fair lending concerns and the current and future requirements of secondary market participants.

Before acquiring or being acquired by another bank, institutions should determine how its mix of qualified and non-qualified mortgage products impact the overall value of the portfolio, whether new lending suitability and other related requirements impact the repayment prospects and foreclosure rights of their mortgages, the extent to which its mortgages will be acceptable collateral or be able to securitized and whether mortgage product choices increase the risk of fair lending and other discrimination charges.

Even if acquirers are willing to proceed, regulatory approval may be difficult to get where a CFPB enforcement proceeding is percolating and/or a significant fines are anticipated.

**Size and Stability**

There is a fundamental threshold question that may impact future consolidations: is it worth the increased regulatory requirements to get larger?

Dodd-Frank and its implementing regulations impose escalating regulatory requirements as institutions reach increasing size thresholds. Bank holding companies will no longer be exempt from capital requirements at the holding company level once they reach $500 million in assets. At the $10 billion and $15 billion asset thresholds, additional regulatory requirements and limitations will apply, including becoming subject to CFPB jurisdiction. Finally, bank holding companies with greater than $50 billion in assets are subject to enhanced prudential regulation by the Federal Reserve.

Regulators are now required to evaluate certain mergers and acquisitions through the prism of financial stability established by Dodd-Frank before approving the consummation of such transactions. Restraints on combinations that will exacerbate pressures on U.S. economic systemic stability have been interpreted by some as meaning that banks over a certain size will have a challenging time justifying significant mergers or acquisitions. Of equal significance are management capabilities and risk management functions of the resulting bank.

To achieve regulatory approval of future combinations, it will be important for large and regional

banks to demonstrate the adequacy of capital given the nature of inherent risks in the resulting bank; the acumen of management and risk management tools; the limited interconnectedness of the resulting bank with other large financial companies; the relative transparency and straightforward nature of the bank's business model and the ease with which the bank, its parent company and subsidiaries can be resolved in case they fall prey to financial distress.

Banks are now operating in yet another new regulatory environment. Those that are fluent in this new language of regulatory requirements will be better equipped for their future, whether it means operating independently or engaging in a consolidation transaction.