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## Obama's big bank size limit proposal could help small rivals

Observers squabble over usefulness of cap on the size of 'too-big-to-fail' banks

By **Ronald D. Orol**, MarketWatch

**WASHINGTON (MarketWatch) --** President Obama's proposal to limit the size and trading activity of the nation's biggest banks shook the financial world, leaving analysts and academics to bicker over whether it would help avert a financial crisis resembling the one that shook the economy to the brink in 2008.

At issue is a provision in the White House proposal made Jan. 21 that seeks to deter commercial banks from becoming so big that they put the broader economy at risk. The proposal would create a cap on how big an institution can grow through acquisitions.

This proposal, combined with other new limits on big banks, has been dubbed "The Volcker Rule" after former Federal Reserve Chairman Paul Volcker, who chairs Obama's economic advisory panel and was a key backer of the measures.

### Too-big-to-fail banks?

Biggest bank-holding companies by assets\*

INSTITUTION	ASSETS
Bank of America	\$2,252,813,550
JPMorgan Chase	2,041,009,000
Citigroup	1,888,599,000
Wells Fargo	1,228,625,000
Goldman Sachs	882,586,000
Morgan Stanley	769,503,000
Metlife	535,192,209
HSBC N. Amer. Holdings	390,657,817
Barclays Group US	377,926,385
Taunus	368,225,000

Source: Federal Financial Institutions Examination Council

\* In thousands of dollars, as of Sep.30, 2009

Volcker is scheduled to testify about the proposal before the Senate Banking Committee on Tuesday. In addition to limiting the size of banks, the Volcker rule would prohibit commercial banks from owning hedge funds and buyout shops. Big banks with depositors would also be forbidden from engaging in certain riskier trades. [Read Volcker in his own words](#)

The Treasury Department plans to release more details about the proposal in the coming weeks, after discussions with key lawmakers including outgoing Senate Banking Committee Chairman Christopher Dodd, D-Conn.

Lawmakers are also considering other 'too-big-to-fail' restrictions, which Volcker argues would complement the new restrictions Obama proposes. Those include leverage limits and a measure that would have big banks hold a special kind of capital that leave institutions with less debt and more equity and liquidity during a systemic crisis.

Nevertheless, the Volcker proposal comes at a time when the largest banks have become even larger through major acquisitions assisted by the government as part of efforts in late 2008 to stem the expanding financial crisis. Rep. Marcy Kaptur, D-Ohio, argues that after the dust settled five institutions -- she calls them leviathans -- control most of the credit in the country.

"Before the crisis they [largest banks] held 30% of the deposits, now they hold 40% of deposits, they're going up to 50%. Five banks. Too big," Kaptur said.

**Who decides how big is too big?**

Without providing much detail yet, the Obama administration would like to see Congress create a limit modeled, in part, on a 10% cap on nationwide deposits that policymakers imposed in 1994. Congress prohibited banks from acquiring institutions that would result in the acquiring bank holding more than 10% of U.S. bank deposits.

Proponents contend that it's difficult for regulators to manage the impact to the economy of a Lehman-style collapse, even with expected restrictions on capital and leverage. With size limits, even if banks aren't required to divest divisions, regulators could limit the biggest institutions from getting bigger and more dangerous to the system.

However, critics contend that it would be impossible for regulators to identify why they chose a specific size cap, which they argue would distort normal competitive forces if it is set too low. A cap that is too high, they contend, would be meaningless.

Already Republicans and Democrats on Capitol Hill are squaring off about whether it would have a positive or negative impact on the economy.

"Who is it that is going to determine what size is too big?" asked House Minority Whip Eric Cantor, R-Va. "That's a very difficult equation to charge any one with in this town, much less anywhere else."

Cantor said he opposes the approach taken by the Obama administration, arguing that regulators should focus on making sure bank regulators can make sure financial institutions hold sufficient capital and aren't over-leveraged.

"We know that too much leverage led to the near collapse of our entire system over a year ago. If we're going to have banks enjoy some backing by the taxpayers, regulators should have ability to set capital requirements so that banks can be healthy and we don't have this happen again," he said.

However, Democrats seem to be taking a different tack.

"Yes there should be a cap on the size of financial institutions and it should be measured by their total liabilities to U.S. persons," said Rep. Brad Sherman, D-Calif. Sherman, who is a member of the influential House Financial Services Committee, said whatever cap the U.S. proposes, it should limit the amount U.S. individuals would lose if the institution collapses. In other words, Sherman said, a financial institution should not be allowed to grow so large that its collapse would cause the U.S. Gross Domestic Product to fall by 1% or more.

### **Different approaches**

The Treasury could contemplate a variety of different approaches for how to cap the size of banks. One approach could be to prohibit a bank from having liabilities that exceed a certain percentage of the U.S. Gross Domestic Product, according to a report by Concept Capital.

With GDP at roughly at \$14.2 trillion, a 10% cap of this sort would act as a prohibition on a financial firm from buying another bank and having more than \$1.42 trillion in liabilities.

Christopher Whalen, director at Institutional Risk Analytics in Torrance, Calif., said a Treasury could consider an asset cap, where a bank couldn't control more than 10% of the total amount of U.S. bank industry assets -- deposits and other investments.

"I would add the total industry assets to securitizations as well, and use that as the basis for any cap on total assets," Whalen said.

Bank holding company assets have grown to \$16.8 trillion as of the end of September. A 10% cap on bank assets would prohibit the largest financial institutions from having more than \$1.68 trillion in assets.

Based on that structure, three U.S. financial institutions would be over the cap. According to an inter-agency bank regulatory group, the Federal Financial Institutions Examination Council, Bank of America has \$2.25 trillion in assets as of Sept. 30, 2009. J.P. Morgan Chase has \$2 trillion and Citigroup has \$1.9 trillion in the same period. [Read the latest statistics on bank holding company assets here.](#)

Vikas Agarwal, a professor at Georgia State University's Robinson College of Business, contends that a cap on the size of banks would give rival smaller banks an advantage of not being swallowed up by the giants.

Agarwal contends that a proposal to cap the size of banks through deals could be the White House signaling that they recognize that bank regulators have a hard time monitoring and controlling the size of financial institutions through their existing examination and capital controls approach.

However, Steven Kaplan, professor of finance at the University of Chicago, argues that a limit on the size of financial institutions would trickle down to hurt consumers seeking bank loans, in the long run. He added that limits on the size of banks and other restrictions are "over-kill," and simply Democrats seeking to score political points with the public.

"This proposal is all about politics and not about substance," Kaplan said.

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