SmartMoney

Consumer Action by AnnaMaria Andriotis Published January 22, 2010

How Plan to Curb Banks Could Help Consumers

President Obama's proposed legislation to limit the size and risk-taking of large financial institutions had an immediate impact on the stock market Thursday, as traders sold off shares of **Citigroup** (*C*[1]), **Bank of America** (*BAC*[2]) and **JPMorgan Chase** (*JPM*[3]). But the new regulations, which are designed to promote broader financial stability, could also affect everyday consumer banking down the road.

Checking accounts, credit cards and loan applications could all be affected by tighter regulations that limit banks' activities and investments. The details of the administration's plan are still emerging, but bank analysts, business professors and financial consumer advocacy groups say that consumers could be in for some relief, including better access to loans and more competitive rates, as competition between large and small banks increases to retain customers.

The proposal is designed to prohibit bank-holding companies from engaging in proprietary trading – when a firm actively trades financial instruments with its own money to make a profit for itself – and from owning, investing in or sponsoring hedge funds or private-equity funds. The new limits would also seek to curb industry consolidation, in part by placing a cap on institutions' market shares. The proposals require approval by Congress before going into effect – two votes that could be a long time coming.

Here are four areas of consumer banking that may be impacted if the new proposals become law.

Lending

If proprietary trading is prohibited, large banks could look to replace that revenue stream by lending more to consumers.

Lending isn't much less lucrative than proprietary trading, says Matthew Richardson, a Charles E. Simon professor of applied financial economics at the New York University Stern School of Business. "If these banks are capital constrained – and in the long run that's a possibility" – they could consider increasing their availability and accessibility of loans, he says.

Vikas Agarwal, an associate professor of finance at the J. Mack Robinson College of Business at Georgia State University, says "it's only a matter of time before banks will have to get back into lending." But the high returns on lending come from underwriting loans to riskier borrowers, so the question then becomes whether banks are ready to return to lending to subprime borrowers – an unlikely scenario in the near term.

On the other hand, a lag in the secondary market could keep banks from increasing loans to consumers, says Charles Whitehead, an associate professor of law at Cornell University who specializes in financial regulation.

Credit Checks

Should banks turn to increased lending to replace lost revenue, they could be more lenient in offering loans or require lower credit scores than those currently in place.

But, again, don't expect to see the subprime lending of 2004 through early 2007 return any time soon. "[The banks] would hopefully keep their underwriting standards solid," says Matthew Albrecht, a diversified bank analyst at Standard & Poor's who covers JPMorgan, Citigroup, Bank of America and **Wells Fargo** (*WFC*[4]).

Banks will likely return to lending to consumers with poor credit down the road, he says, but as of now, most still have sizable portfolios in which charge-offs (from unpaid debts) are increasing.

Credit Cards

The market for credit cards has become a bit more competitive during the past year or so, as more small banks and credit unions have stepped in to fill in the void left by the large banks.

With these institutions offering competitive rates on credit cards, big banks are unlikely to look to make up their revenue losses by jacking up interest rates on their existing or new credit cards -- especially for consumers with good credit, says Agarwal. "The market is very competitive, and it's hard to say they can do this and survive."

If the credit-card sector is impacted at all as a result of these proposals, consumers should look out for more card offers, as banks try to increase revenues by penetrating new consumer markets, Agarwal says.

Fees

Financial institutions probably won't turn to new consumer banking fees to make up for revenue lost as a result of these proposals.

The attention new fees could draw might trigger more scorn from Washington, says Ed Mierzwinski, the consumer program director at the U.S. Public Interest Research Group. "If the banks try to bring higher fees on this [proposal], it will backfire on them because it will put more pressure on Congress to be stricter" with their regulations in the financial sector, he says.

Separately, the new proposals could create more competition between big and small banks, as the larger firms try to retain and attract new customers, says Gail Cunningham, a spokeswoman for the National Foundation for Credit Counseling. Consumers could find lower fees and banking promotional incentives like fewer ATM fees, regardless of where transactions occur, she says.

[1]http://www.smartmoney.com/quote/C/
[2]http://www.smartmoney.com/quote/BAC/
[3]http://www.smartmoney.com/quote/JPM/
[4]http://www.smartmoney.com/quote/WFC/
URL for this article:
http://www.smartmoney.com/personal-finance/debt/proposed-limits-on-financials-could-improve-consumer-banking/